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## COPYRIGHT ARBITRATION ROYALTY PANEL

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In the matter of:

Digital Performance Right in  
Sound Recording and Ephemeral  
Recording

Docket No.  
2000-9

CARP DTRA  
1 & 2

CARP Hearing Room  
LM-414  
Library of Congress  
Madison Building  
101 Independence Ave, SE  
Washington, D.C.

Thursday  
September 6, 2001

The above-entitled matter came on for hearing,  
pursuant to notice, at 9:00 a.m.

BEFORE

THE HONORABLE ERIC E. VAN LOON	Chairman
THE HONORABLE JEFFREY S. GULIN	Arbitrator
THE HONORABLE CURTIS E. von KANN	Arbitrator

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ORIGINAL

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National Religious Broadcasters Music License  
Committee, and Salem Communications Corporation

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## C-O-N-T-E-N-T-S

WITNESSDIRECT CROSS REDIRECT RECROSS**Joe D. Davis**

By Mr. Joseph	8540	8612
		8622

By Mr. Winters	8567	
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**Douglas Talley**

By Ms. Aistars	8628	8680
By Mr. Garrett	8650	

EXHIBIT NO.DESCRIPTIONMARK RECDRIAA

204 DPX	Salem Communications 2000 Annual Report	8574 8578
205-209 DPX	Salem Quarterly Earnings Press Releases	8578 8585
210 DPX	Los Angeles Business Journal Article 14 January 29, 2001	8540
211 DPX	Salem Press Release, WZFS Launch	8596 8605
212 DPX	Salem Press Release, WFSH Launch	8601 8605

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P-R-O-C-E-E-D-I-N-G-S

(9:01 a.m.)

CHAIRMAN VAN LOON: Good morning, everyone. I hope we're in shape to proceed and that we've recovered from last night.

Having had a long administrative and procedural discussion at the end of the day, I wouldn't imagine that there are any other procedural issues right now. But just in case, before we begin with the witness, are there anything?

MR. GARRETT: There's nothing from our side, Your Honor.

MR. STEINTHAL: Nothing, Your Honor.

CHAIRMAN VAN LOON: Excellent.

In that event, we'd like to welcome our first witness this morning. Good morning. Please come up and assume the witness chair here. This microphone is what will be picking things up for your testimony, so if you can avoid putting paper on top of it, that makes John's job a lot easier.

Welcome, and we appreciate your being here. And let me ask you to raise your right hand to

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1 be sworn in at this time.

2 WHEREUPON,

3 JOE D. DAVIS

4 was called as a witness and, having been first duly  
5 sworn, assumed the witness stand, was examined and  
6 testified as follows:

7 DIRECT EXAMINATION

8 BY MR. JOSEPH:

9 Q Good morning, Mr. Davis. Would you please  
10 state your full name for the record, and spell your  
11 last name for the Court Reporter?

12 A Joe, middle initial D, Davis, D-A-V-I-S.

13 Q And what is your current employment and  
14 position, Mr. Davis?

15 A I am Senior Vice President for Operations,  
16 Salem Communications Corporation.

17 Q How long have you held that position?

18 A This particular position just since  
19 September of 2000.

20 Q What position did you hold before you were  
21 Senior Vice President for Operations?

22 A I was a Regional Operations Vice President

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1 in charge of I believe five markets.

2 Q And how long did you hold that position?

3 A Since mid-'97.

4 Q How long in total have you been with Salem  
5 Communications?

6 A I joined Salem in August of 1989. I think  
7 that would be about 12 years.

8 Q If we're subtracting correctly, that  
9 sounds about right.

10 Can you tell us briefly, or tell the Panel  
11 briefly, what your job responsibilities are as -- in  
12 your current position of Senior Vice President for  
13 Operations?

14 A Well, I still maintain primary  
15 responsibility for a number of major markets in the  
16 east, including Boston, New York, Atlanta, Tampa,  
17 Pittsburgh, and Cleveland. But I also have the  
18 responsibility for coordinating the work of all of the  
19 operations vice presidents, and it gives me some  
20 oversight of all the stations that are owned and  
21 operated by Salem throughout the United States.

22 CHAIRMAN VAN LOON: Are you physically

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1 located in the northeast or where?

2 THE WITNESS: I'm located in New Jersey.

3 BY MR. JOSEPH:

4 Q So instead of having to fly across country  
5 we had a train ride to get here.

6 A Right.

7 Q And what is your involvement in the  
8 internet operation of Salem's radio stations?

9 A You stated correctly it is with Salem  
10 radio stations, not with our internet company, which  
11 is a subsidiary. I often am involved in the decision  
12 on the content of a website or whether or not to  
13 stream or how to use web resources to supplement or  
14 complement the use of the radio station itself.

15 Q And what is the purpose of your testimony  
16 here today?

17 A My testimony today is oriented towards  
18 describing how certain stations use music. By  
19 "certain stations," I'm referring primarily to  
20 religious-oriented radio stations, and similar  
21 stations that are program-oriented and use music far  
22 less as a part of their total programming elements

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1 than a typical general market radio station. And also  
2 to ask that fairness be extended to these stations in  
3 the deliberations of this committee.

4 Q And in the setting of the fee and the  
5 structure of the fee?

6 A And that the fee structure represent that  
7 limited use of music by these stations as opposed to  
8 the music-intensive stations.

9 MR. JOSEPH: At this point, I'd offer the  
10 witness for voir dire.

11 MR. WINTERS: We'll reserve for cross.

12 MR. JOSEPH: Okay.

13 BY MR. JOSEPH:

14 Q Mr. Davis, could you tell the Panel a  
15 little bit about the history of Salem Communications?

16 A Salem Communications started in the late  
17 '60s when two brothers-in-law, Edward Astinger and  
18 Stuart Epperson, merged their radio holdings, and I  
19 don't remember, four or five stations were involved,  
20 and it became Salem Communications.

21 It grew moderately, as stations did in  
22 those days before deregulation and clustering. And

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1 when I joined the company in 1989 I think we were the  
2 14th radio station to go on the air. Since then, you  
3 know, deregulation has occurred, clustering has become  
4 the rule rather than the exception, and we are now  
5 owning and operating somewhere close to 85 radio  
6 stations around the country, many of them in major  
7 markets.

8 And we have other holdings, such as a  
9 network and another media company that includes some  
10 internet holdings. But primarily we're pure public  
11 broadcasters owning or operating about 85 radio  
12 stations at this point.

13 ARBITRATOR GULIN: I think I must have  
14 misunderstood a little bit of your -- what you said.  
15 In '89 you were the 14th station to go on the air?

16 THE WITNESS: We were the 14th Salem  
17 station to go on the air.

18 ARBITRATOR GULIN: Oh, Salem station. I  
19 see.

20 THE WITNESS: In 1989. The radio industry  
21 has grown dramatically, Your Honor, since 1989.

22 ARBITRATOR GULIN: Yes.

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1 (Laughter.)

2 THE WITNESS: The company has grown  
3 primarily due to deregulation --

4 ARBITRATOR GULIN: I gotcha.

5 THE WITNESS: -- and consolidation. And  
6 it went public in 1999.

7 BY MR. JOSEPH:

8 Q Okay. Now, could you describe for the  
9 Panel the formats, programming formats, used or  
10 employed by Salem's radio stations?

11 A Of our 85 stations, 49 of them -- 48 or 49  
12 are what we would call religious talk teaching, and  
13 I'll come back and explain a little bit more about  
14 what I mean by that, because it's important that it be  
15 understood. Another nine are pure talk radio  
16 stations, news, news talk, that type of thing.

17 Twenty of them are music-oriented  
18 stations, some contemporary Christian music --  
19 actually, I think it's 19 -- contemporary Christian  
20 music, other forms of music. And then the final nine  
21 are other formats, and it could vary from foreign  
22 language to sports talk to nostalgia music. So that's

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1 the range of formats that our owned and operated  
2 stations provide.

3 Q But it sounds like the focus is on the  
4 religious teaching and talk formatted stations?

5 A Focus has always been on the religious  
6 teaching and talk. That's really where we began. And  
7 if you go into a market, our first station will always  
8 be in that format.

9 Q Okay. Could you tell the Panel what you  
10 mean by "religious teaching and talk" and what the  
11 characteristics of that format are?

12 A Religious teaching and talk is  
13 considerably different from other formats, in that we  
14 dedicate our time to others who produce religious-  
15 oriented programs. We've identified something like,  
16 oh, maybe 250 programs around the country that have  
17 compelling content of a religious or family issues  
18 nature.

19 And we sell blocks of time to those  
20 programmers. Those blocks of time might be 25, 26  
21 minutes, might be 56 minutes, might be 13 minutes, and  
22 the remaining portion is dedicated to spot

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1 advertising. So they become our programs on those  
2 radio stations, and those programs are produced by  
3 others and delivered to us, and we simply put them on  
4 the air.

5 Many of them are preaching programs. Some  
6 of them are teaching. We have one that takes you  
7 through the Bible over a period of five years, just  
8 step-by-step Bible study. And they send the listener  
9 a study guide.

10 They receive their funds by raising money  
11 on the air or selling study guides or merchandise or  
12 tapes or something like that, and then they pay us for  
13 the time. And they're typically just a didactic  
14 period of time.

15 We have some programs that are religious  
16 liberty issues, some programs that are question and  
17 answers about the Bible, some programs that are  
18 counseling about marriage and family. But a typical  
19 talk teaching station has just a series of these  
20 programs 24 hours a day, seven days a week.

21 Q Now, you mentioned that they sell blocks  
22 of time. Do they also raise revenues or generate

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1 revenues in other ways?

2 A The stations?

3 Q The stations.

4 A Yes, by selling advertising, just like any  
5 general market radio station would. During those  
6 minutes we retain, those stations sell advertising, at  
7 least the Salem stations do. However, they're  
8 somewhat constrained in the advertising they sell.  
9 First of all, they have to have an advertiser that  
10 wants to be in that environment.

11 Secondly, you have to realize that these  
12 programmers take up the majority of the time with  
13 their content. And, thirdly, they have to realize  
14 that our audience is a unique audience, and that they  
15 would have some interest in it.

16 Q And could you give the Panel an idea of  
17 the approximate mix of revenue for the religious  
18 teaching and talk stations between the program sales  
19 and the spot advertising?

20 A When I came with the company it was -- it  
21 was probably 80 percent program revenue and 20 percent  
22 spot revenue. As we've gotten better at selling

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1 spots, it's now about 60 percent. For our talk  
2 teaching stations it's about 60 percent program  
3 revenue generated by the sale of these programs, and  
4 then 40 percent from the sale of traditional spot  
5 advertising.

6 Q Now, how do these religious teaching and  
7 talk stations typically use music during -- well,  
8 first focusing on the programs. How do the programs  
9 typically use music, and then how do the stations  
10 otherwise typically use music during the broadcast  
11 day?

12 A To understand how music is used on a talk  
13 teaching station, you need to understand, first of  
14 all, how the programmers use it. And for some it's  
15 not at all. In fact, I would say for quite a few it's  
16 not at all. Those that do use it often only use it as  
17 an opening theme, and even then it's something  
18 sometimes that somebody in their church played on the  
19 organ and they record it and they use it on their  
20 theme, or on a synthesizer or something like that.

21 So you'll hear it then. You'll hear it as  
22 a production aid from the production libraries of the

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1 station on their spot announcements. You will  
2 occasionally hear it on a weekend church program,  
3 where Sally Smith gets up and sings the Old Rugged  
4 Cross or something like that, or where the choir sings  
5 on a church program that's either live or recorded.

6 Then, it will also be used sometimes by  
7 stations to fill in time that is unsold to programs.  
8 Occasionally you'll have a cancellation, or maybe you  
9 won't be able to sell some time in the middle of the  
10 night. You might use some fill music at that time to  
11 complement or to keep something on the air.

12 Q Okay. And, by the way, just going back to  
13 the programs for a minute, who decides what music, if  
14 any, to use in the program? Is that something decided  
15 by the station?

16 A No. The programmers themselves do that.  
17 The station really does not provide any -- much  
18 guidance at all, really, on how they produce the  
19 programs. These are syndicated programs that are also  
20 used by other stations, many of whom are on this NRB  
21 Committee.

22 So the programmers are people who've made

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1 a decision as to how -- how to approach the  
2 programming. The day was when they would have a  
3 little bit of music. I think of some of the programs  
4 from years ago that would mix music as part of their  
5 programming. I don't know that there are any of those  
6 left. Virtually all of them now are just pretty much  
7 didactic.

8 Q Okay. Now, you mentioned the NRB  
9 Committee. You're here also on behalf of the National  
10 Religious Broadcasters Music License Committee, is  
11 that correct?

12 A That is correct.

13 Q Could you describe the NRBMLC for the  
14 Panel?

15 A That committee was formed before my time,  
16 at least before my tenure with Salem -- I think maybe  
17 in the '80s -- to pull together those stations that  
18 broadcast in a religious format, but also others who  
19 made a very limited use of music -- stations who felt  
20 that their circumstance was special and that they  
21 needed to negotiate with ASCAP, BMI, and SESAC for  
22 rates that adequately reflected their limited use of

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1 music.

2 Q Okay. And now, there are also here -- or  
3 the stations -- the NRBMLC has also been asked to  
4 represent certain stations here in connection with --

5 A Yes. As a matter of fact, those same  
6 stations have asked that the NRBMLC represent them in  
7 these proceedings as well.

8 Q Now, about how many stations are  
9 represented by the NRBMLC here in this proceeding?

10 A The latest number I've seen, something  
11 like 217, I believe. And that consists of both  
12 commercial and non-commercial radio stations.

13 Q Do you have any understanding as to the  
14 size of the commercial radio stations represented by  
15 the NRBMLC in this proceeding?

16 A Yes, I do. It would be a few large  
17 stations, like those operated by Salem, in major  
18 markets like New York, Los Angeles, Chicago, San  
19 Francisco, Dallas, Atlanta, etcetera. It would be an  
20 awful lot of very, very small stations, many of whom  
21 are mom and pop stations where the manager of the  
22 station is also heard on the air, or maybe his wife

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1 comes in and does the books on the weekend, and just  
2 extremely small operations in many cases.

3 Q Okay. And what is your understanding of  
4 the formats employed by the radio stations represented  
5 here by the NRBMLC?

6 A The vast majority of them are the formats  
7 I've described to you, the religious talk and  
8 teaching. Some of them will use music, either on the  
9 weekends or as fill overnight or something like that.  
10 Some of them are, indeed, music stations. But the  
11 vast majority of them are the talk teaching formats  
12 that I've described for you.

13 Q And how do these commercial stations  
14 represented by the NRBMLC typically generate revenue?

15 A Much the way I've described, through the  
16 sale of programs and through the sale of spots. We  
17 actually divide that into four sources of revenue at  
18 Salem. We say local spot, national spot, and local  
19 program, national program. But that's a small  
20 distinction. It's really spot and program.

21 However, the smaller stations don't do a  
22 very good job at selling spots, and they would tell

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1       you that. So the vast majority of their income, in  
2       some cases I think virtually all of the income, comes  
3       from the sale of programs, simply because of their  
4       lack of ability to get out on the street and sell  
5       spot.

6               Q       And how do the non-commercial stations  
7       represented by the NRBMLC generate revenue?

8               A       Non-commercial stations typically receive  
9       contributions from their community, and in the small  
10      communities that's very tough because they're up  
11      against other people that are raising money. There  
12      are always a lot of good cause concepts out there.  
13      And so their funds -- the funds are very limited by  
14      the donation pool.

15              Q       And what can you tell us about the size of  
16      the non-commercial stations represented here by the  
17      NRBMLC?

18              A       Well, I can give you an impression based  
19      on the fact that I see these people once a year at the  
20      NRB convention. This year it will be in Nashville.

21                      And as every year, you see these people  
22      pull up in their campers and vans unable to come in

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1 and afford a hotel room. Probably unable to come up  
2 with \$30 for a meal, because I've bought them a lot of  
3 meals, sometimes while they were asking for a donation  
4 of a microphone or a turntable, or something like  
5 that, to help them out.

6 So my impression is that they are people  
7 of very limited means who have, you know, very well-  
8 intentioned people who are in it for ideological  
9 reasons, and who simply don't have much in the way of  
10 resources, either personally or through their radio  
11 stations.

12 Q And would that description apply also to  
13 some of the -- some of the commercial stations  
14 represented by the NRBMLC?

15 A Yes, it would, because, again, our format  
16 is often ideologically driven, and people get in it  
17 for reasons that have nothing to do with the return.

18 Q Let's turn back to the Salem stations.  
19 I'd like to focus your attention on those stations'  
20 use of the internet.

21 A Okay.

22 Q Do any of Salem's radio stations maintain

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1 internet websites?

2 A We like to think that virtually all of  
3 them do. There may be three or four that are either  
4 transitioning into it or out of it or into another  
5 site or something. But I believe virtually all of  
6 them use the web in some way or another.

7 Q And what do those websites typically  
8 contain?

9 A Well, the first thing they'll usually  
10 contain is a program guide, so someone can come on and  
11 see what to expect and when to expect it. Programs  
12 change, as I mentioned, every 15 minutes or every half  
13 hour. So the first thing is a program guide.

14 Secondly, there might be just kind of a  
15 community calendar, something -- what events are going  
16 on in the Christian community, the religious  
17 community, coming up in churches and things like that,  
18 what speakers are coming to town, those kinds of  
19 things.

20 Thirdly, there might be something about  
21 the station and its personalities. There might be  
22 some contesting or some promotion on there. That's

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1 typically what they contain. And then they will often  
2 have links to our programmers, and sometimes to the  
3 audio streams of our programmers.

4 Q Now, when you refer to the audio streams  
5 of your programmers, what do you mean by that? Could  
6 you elaborate on that a little bit more?

7 A As I mentioned, these programmers produce  
8 programs, usually daily programs, with compelling  
9 content that we carry on our radio stations. But  
10 through our internet company we've also gone to them  
11 and offered to stream their programs on the internet,  
12 either in a -- well, I guess it's all -- it's all  
13 archived.

14 We put their programs on, so that our  
15 listeners can go in and maybe check the last 30 or 60  
16 days and pick up something that they've missed on the  
17 radio. Radio is real time, as you know, so if you  
18 miss it you miss it. But you can go to the internet  
19 and hear that same program.

20 So our radio stations will typically have  
21 click throughs that will allow the listener to go back  
22 and hear a program that they've missed or hear a

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1 speaker that they particularly like. And I think we  
2 have 129 of those right now that are doing business  
3 with One Place, our internet company, and which we  
4 have access to through virtually all of our radio  
5 sites.

6 Q That's 129 programmers, different  
7 programmers?

8 A Yes, it is. And each of them might carry  
9 30 to 60 programs in their archive on the web, so that  
10 you could go back and access those. Those are those  
11 same programs I described earlier which are just  
12 pretty much didactic in nature.

13 Q Now, you've said they contract with One  
14 Place, I think, or that One Place has made  
15 arrangements with them. Who is paying whom in that  
16 arrangement? Is One Place paying the programmer for  
17 the privilege of having the program carried?

18 A No. As a matter of fact, the paradigm is  
19 exactly the opposite, and that's very important. The  
20 programmers are paying One Place to stream this  
21 programming. And you can access it three different  
22 ways, by the way. You can go to the station website,

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1 you can go to the ministry website, or you can go to  
2 the One Place website, and pick up these programs.  
3 But it's important to know that they pay us, we don't  
4 pay them.

5 Q Now, you mentioned a number of things that  
6 the Salem stations do on their websites. Do any of  
7 them also allow you to hear internet streams of their  
8 broadcast programming?

9 A Of the stations themselves?

10 Q Yes.

11 A Fifteen of them do. Ten of them are the  
12 talk teaching format stations. Five of them are music  
13 stations. So of the stations, about -- well, right  
14 now it is 15 -- 10 talk teaching and five music  
15 stations -- are streaming on the internet through One  
16 Place.

17 Q Now, you say through One Place, are they  
18 also doing it through their own websites?

19 A Well, I know of one station, our talk  
20 station in Phoenix, that's doing it through another  
21 vendor. So I wouldn't have total knowledge of anybody  
22 that's doing it through another vendor. I don't think

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1 -- I can assure you that nobody else is streaming  
2 music through another vendor. One of our -- one or  
3 two of our talk stations might be streaming talk  
4 through another vendor.

5 Q So the total might be more than 15.

6 A It might be. But it's still -- it's still  
7 only five music stations.

8 Q Now, why do these stations stream --  
9 simultaneously stream their broadcasts over the  
10 internet?

11 A Well, every radio station that I know of  
12 is looking for ears, and we go to the internet in  
13 hopes that we can gain a few more ears.

14 Q Have they been finding it worthwhile?

15 A The jury is still out. You know,  
16 certainly, you do gain a few more ears. The question  
17 is: how do you look at it as a cost benefit? Some  
18 have looked at it and decided it wasn't worth the  
19 investment.

20 Q In your written testimony you made a  
21 reference to WMCA. Could you tell the Panel a little  
22 bit more about what happened with WMCA, for example?

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1           A       Well, WMCA is one of our largest radio  
2       stations. It serves New York City. And for nearly  
3       two years it streamed its entire content. Came to  
4       budgeting time last October, and One Place, our own  
5       company who had been trading this service to us in  
6       exchange for spot announcements, all of a sudden said,  
7       "We're going to charge you \$1,500 for the bandwidth to  
8       stream your radio station." What's that? \$18,000 a  
9       year I think. I don't have a calculator, but I think  
10      that's what it is.

11                We looked at it. We looked at a listing  
12      of the hits and where they were coming from, and we  
13      said, "You know, that \$18,000 a year could probably be  
14      better spent." We could buy billboard. We could, you  
15      know, get some taxicab backs. Or maybe we could hire  
16      a part-time person or something to do some direct mail  
17      or something like that.

18                But a decision was made that \$18,000 just  
19      was too much money in terms of the benefit, the ears,  
20      that were being gained for that large radio station.

21           Q       So they ceased streaming.

22           A       They ceased streaming on November 1st of

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1 last year.

2 Q What is Salem's present view as to the  
3 pros and cons of continuing to offer radio streaming?

4 A That depends on who you talk to. There  
5 are still some people who are caught up in the  
6 euphoria, but for the most part, as I said earlier,  
7 the jury is still out. Salem, as a company, doesn't  
8 have a position or a conclusion on whether or not  
9 streaming is beneficial enough to continue it in every  
10 case.

11 Like I say, there have been -- there is  
12 another station in Pittsburgh that's under my direct  
13 supervision that was streaming. It also ceased  
14 streaming this past year.

15 Q Now, Mr. Davis, are you familiar with the  
16 \$5,000 per station minimum fee that RIAA has proposed  
17 for this proceeding, during this proceeding?

18 A I have heard about that.

19 Q In your opinion, how would it affect the  
20 streaming of the stations represented by the NRBMLC?

21 MR. WINTERS: I'm going to object to that  
22 question. It's not referenced in his direct testimony

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1 at all.

2 MR. JOSEPH: Allow me to take a quick  
3 look, because I thought that there was a discussion of  
4 the --

5 THE WITNESS: There was, indeed. Your  
6 Honor, I did this over the --

7 CHAIRMAN VAN LOON: Please check and  
8 direct our attention to wherever it is. I remember  
9 a --

10 ARBITRATOR VON KANN: There is some  
11 reference in paragraph 14 to the 250 minimum.

12 CHAIRMAN VAN LOON: Right. I remember  
13 that reference to --

14 ARBITRATOR GULIN: And there's a reference  
15 to minimum fee in 15 also.

16 MR. GARRETT: I think the point is there's  
17 no reference, obviously, to our proposed fee. I also  
18 think that to talk about it as the \$5,000 minimum is  
19 a mischaracterization of what it is that -- what we've  
20 proposed here. But in any event, it was clearly  
21 beyond the scope of his direct testimony.

22 MR. JOSEPH: Well, I --

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1 CHAIRMAN VAN LOON: Overruled. Go ahead  
2 and continue to answer.

3 BY MR. JOSEPH:

4 Q And if you need me to repeat the question,  
5 I'm happy to do that.

6 A Well, I know I talked about the \$250 fee,  
7 which I felt and continue to feel was too much for  
8 these little stations that can't afford \$30 for a meal  
9 or \$100 for a hotel room. So the \$5,000, or whatever  
10 number you've quoted, is just beyond the scope of the  
11 thinking of most of these stations. I can't even  
12 imagine. I supervise some fairly large stations, and  
13 I turn down \$5,000 expenditures because of cost-  
14 benefit issues all the time.

15 Q And is there -- do you have an opinion as  
16 to how the -- a minimum fee in the range of \$5,000  
17 would relate to stations that use more limited amounts  
18 of music, in particular?

19 A Well, again, I -- keep in mind a lot of  
20 these stations buy a license from ASCAP/BMI, if I can  
21 use that analogy, only as a defensive measure. They  
22 may never play music. But they don't want to get in

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1 trouble if they do or if one of their programmers do.

2 So they pay the fee and don't consider it  
3 -- you know, they have a special fee I guess. But it  
4 just isn't -- isn't something that seems to be fair,  
5 to have a high fee for such limited use.

6 ARBITRATOR VON KANN: Do you know what  
7 those fees typically run from ASCAP/BMI?

8 THE WITNESS: No, sir, I don't. You know,  
9 I should remember some of them, but I -- because there  
10 are so many markets involved, and so many different  
11 circumstances, I -- I couldn't add to that.

12 CHAIRMAN VAN LOON: Even a ballpark  
13 number, without having to be too specific?

14 THE WITNESS: I'm trying to think.

15 MR. JOSEPH: Excuse me. But I'd ask Judge  
16 von Kann to clarify whether he's referring to over-  
17 the-air fees or internet fees in this context.

18 ARBITRATOR VON KANN: Well, either. He  
19 just made reference to we -- we buy the license from  
20 ASCAP/BMI.

21 MR. JOSEPH: I think he was --

22 ARBITRATOR VON KANN: And I was just

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1 curious as to what the cost of that purchase is.

2 MR. JOSEPH: I think he was referring to  
3 over-the-air in that context.

4 ARBITRATOR VON KANN: I'll take that, if  
5 he knows.

6 MR. JOSEPH: If you know.

7 THE WITNESS: Let me put it in context.

8 ARBITRATOR VON KANN: Okay.

9 THE WITNESS: I can tell you that after  
10 personnel and health care, it's the third largest  
11 expense of some of our stations.

12 ARBITRATOR VON KANN: Is it in your -- is  
13 it larger than \$5,000, or lower than \$5,000, or do you  
14 have any idea?

15 THE WITNESS: Per month?

16 ARBITRATOR VON KANN: Per year.

17 THE WITNESS: I think in New York it's  
18 larger than \$5,000 per month. Again, I can't attest  
19 to that. I would have to -- because it's an accrued  
20 amount that's paid once a year, I just -- I just can't  
21 remember.

22 ARBITRATOR VON KANN: Okay.

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1 THE WITNESS: But it's a significant line  
2 item. It's one of our larger line items.

3 ARBITRATOR VON KANN: Okay.

4 BY MR. JOSEPH:

5 Q Now, are you here today to ask for a  
6 special or a different fee for religious broadcasters?

7 A No, I'm not. While my expertise is in  
8 religious broadcasting, and that's the world I come  
9 from and I know that world well, I'm here to ask for  
10 fair consideration for stations that make limited use  
11 of music as opposed to music-intensive stations. That  
12 would include religious broadcasters certainly, but it  
13 would also include other formats.

14 MR. JOSEPH: Okay. I have no further  
15 questions. Thank your, Mr. Davis.

16 CROSS EXAMINATION

17 BY MR. WINTERS:

18 Q Good morning, Mr. Davis. My name is Chris  
19 Winters. I work for the RIAA.

20 There's a couple of questions that I  
21 wanted to clear up based on what you just testified  
22 to. You've testified that some of the music performed

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1 on religious stations wouldn't be subject to a  
2 royalty. Because they are performances by a church  
3 choir, that wouldn't be a sound recording, is that  
4 correct?

5 A I don't think I -- my -- I don't believe  
6 I said wouldn't be subject to a royalty. I said it  
7 wouldn't be a sound recording because it was performed  
8 live or performed in the context of a church setting.

9 Q It wouldn't be subject to a royalty  
10 because it's not a sound recording.

11 A I'm not a lawyer. I don't know.

12 Q Okay.

13 A But it's not a sound recording.

14 Q Okay.

15 A That's my testimony.

16 Q Do you have your prepared testimony in  
17 front of you?

18 A I do.

19 Q Would you turn to page -- paragraph 5?  
20 Oh, I'm sorry, page -- you say at the top of page 5,  
21 if you look at the first sentence starting, "For  
22 example." "For example, a guest might sing the Old

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1 Rugged Cross, or a parishioner might perform an  
2 original composition."

3 A Okay.

4 Q "As I understand matters, and I am no  
5 lawyer, such music generally would not give rise to a  
6 sound recording performance royalty."

7 A Okay. All right. Yes.

8 Q And that's correct?

9 A Thank you for refreshing --

10 Q That's your understanding?

11 A That's my understanding.

12 Q From just the music that will give rise to  
13 a sound recording performance royalty, as you  
14 understand it on your religious talk stations, can you  
15 give me an approximation of how many recordings are  
16 played per hour over the course of a day?

17 A For the vast majority of the hours in a  
18 day, I would say zero.

19 Q But if you looked at the day as a whole,  
20 and you looked at all of the songs that were played  
21 over the day, how many songs would that be per hour?

22 A I have no idea.

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1 Q Would it be --

2 A I really don't know.

3 Q -- less than three?

4 A I would think so. But, you know, I  
5 haven't calculated it.

6 Q Okay.

7 ARBITRATOR VON KANN: Can I ask something?  
8 Was that question with respect to all of the stations  
9 generally?

10 MR. WINTERS: Just to the religious --

11 ARBITRATOR VON KANN: The religious talk  
12 teaching --

13 MR. WINTERS: Yes.

14 ARBITRATOR VON KANN: I see.

15 THE WITNESS: Some stations -- and we have  
16 three of our 48 that play music on the weekend, like  
17 on Saturday, they'll play it between noon and 3:00, or  
18 between 3:00 and 6:00. I think there's one here in  
19 Washington that does in the afternoon. But that's  
20 only three of the 48 talk and teaching stations that  
21 we operate that do that.

22 BY MR. WINTERS:

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1 Q So over the course of the day, it's  
2 probably less than three or less than five songs, on  
3 the average, per hour.

4 A Well, those would be on the high end,  
5 whatever that number is. The others -- I suspect  
6 there are some that it's -- the number is still zero.

7 Q And you talked about WMCA stopping  
8 streaming in --

9 A Yes.

10 Q -- your testimony. That's a talk station,  
11 isn't it true?

12 A Talk teaching.

13 Q Talk teaching station, okay.

14 A Yes, it is.

15 Q And you talked about how many stations  
16 were streaming through One Place.

17 A Yes.

18 Q And you said it was 10 religious talk  
19 teaching stations?

20 A Correct.

21 Q And there's also five music stations?

22 A Music stations.

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1 Q And those are over-the-air radio stations  
2 that are retransmitted?

3 A They are.

4 Q Okay. Now, Salem also has some internet  
5 only --

6 A Correct.

7 Q -- music stations, correct?

8 A Correct.

9 Q And one of them is like Christian Pirate  
10 Radio.

11 A Correct.

12 Q Or Pirate Christian Radio. I'm not --

13 A Yes.

14 Q And there's another radio -- internet only  
15 streaming station called Extreme --

16 A Correct.

17 Q -- Pirate Christian Radio?

18 A Correct.

19 Q So if you looked at what Salem is  
20 streaming over the internet, you'd have about 10  
21 religious talk teaching stations.

22 A Correct.

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1 Q And somewhere a little bit more than five  
2 or six or seven music only -- or music-intensive  
3 stations.

4 A Five.

5 Q Five. Plus the internet only stations?

6 A There are internet only stations, both  
7 owned by us and others, and I'm not here to talk about  
8 those. I mean, my testimony is the -- is with regard  
9 to those stations that make a limited use of music.

10 Q Okay. And you testified the overall  
11 breakdown of Salem stations is about 49 religious talk  
12 teaching stations --

13 A Correct.

14 Q -- and nine music-intensive stations?

15 A Nine talk only stations.

16 Q Oh, nine talk only stations.

17 A Bringing it to 58.

18 Q Okay. And then there are --

19 A There are 19 music-oriented radio  
20 stations.

21 Q Okay.

22 A And we're not here to ask for any -- any

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1 special consideration for formats that are not music  
2 -- formats that are music-intensive.

3 Q Okay. Salem is not a not-for-profit  
4 enterprise, correct?

5 A It's a public company.

6 Q It's traded on the NASDAQ, correct?

7 A It is, indeed.

8 MR. WINTERS: At this point, I'd like to  
9 mark -- to hand out what's been marked as RIAA Exhibit  
10 204 DPX.

11 (Whereupon, the above-referred  
12 to document was marked as  
13 Exhibit No. RIAA 204 DPX for  
14 identification.)

15 BY MR. WINTERS:

16 Q Mr. Davis, have you had a chance to look  
17 through Exhibit 204 DPX?

18 A I've seen it before today.

19 Q And this is your Salem Communications  
20 Corporation 2000 Annual Report?

21 A It is.

22 Q And when we printed out your report --

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1 it's a little hard to read the numbers, because of --  
2 it's printed out as a bound volume. But when you  
3 print it off the internet, the numbers show up on the  
4 right side of the page, and you have to bind it  
5 somewhere. So we added our own numbers into it. I'd  
6 like to refer you to --

7 A Could you repeat that? Page numbers, you  
8 mean?

9 Q Page numbers. The page numbers on the  
10 right.

11 A Oh, I see. Okay.

12 CHAIRMAN VAN LOON: They changed your  
13 financials to --

14 (Laughter.)

15 -- make it better for cross examination.

16 THE WITNESS: I wasn't sure I heard that  
17 correctly.

18 CHAIRMAN VAN LOON: As I'm understanding  
19 it, the numbers in the upper right, the page numbers,  
20 have been added.

21 THE WITNESS: Thank you.

22 MR. JOSEPH: I was going to say the

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1 performance looks a whole lot better when --

2 (Laughter.)

3 BY MR. WINTERS:

4 Q If you go to page 3 in the numbers on the  
5 upper right, if I could just direct you to the bar  
6 charts at the top of the page, is that referring to --  
7 if you look at the one in the top left labeled Net  
8 Broadcasting Revenue, that's a reference to the fact  
9 that Salem had \$110 million in revenues from  
10 broadcasting in the year 2000, is that correct?

11 A Correct. That's correct.

12 Q And that was up from \$87.1 million in  
13 1999?

14 A That's correct.

15 Q And if you look down to the next graph  
16 directly below it labeled Broadcast After-Tax  
17 Cashflow --

18 A Correct.

19 Q -- it showed \$23.2 million in the year  
20 2000?

21 A Yes.

22 Q And that's up from \$17.9 million in 1999?

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1 A Correct.

2 Q And broadcast after-tax cashflow is a  
3 pretty good indicator of the health of a broadcast  
4 group, correct?

5 A Correct.

6 MR. WINTERS: At this point, I'd like to  
7 hand out --

8 THE WITNESS: May I correct my response?  
9 The leading indicator of the health of a company is  
10 usually considered to be broadcast cashflow, the  
11 reason being that there are a variety of factors that  
12 can impact the tax considerations. So -- so I would  
13 -- I would not call broadcast after-tax cashflow the  
14 leading indicator, but it's certainly an important  
15 indicator.

16 BY MR. WINTERS:

17 Q It's a good indicator.

18 A A good indicator.

19 Q And it's certainly what your company  
20 highlighted in its annual report.

21 A Well, all -- all four of these are  
22 highlighted.

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1 Q Right.

2 MR. WINTERS: I'd like to move the  
3 admission of Exhibit 204 DPX.

4 CHAIRMAN VAN LOON: Any objection?

5 MR. JOSEPH: Subject to a check for  
6 completeness, no objection.

7 CHAIRMAN VAN LOON: Admitted.

8 (Whereupon, the above-referred  
9 to document, previously marked  
10 as Exhibit No. RIAA 204 DPX for  
11 identification, was admitted in  
12 evidence.)

1 MR. WINTERS: We're handing a series of  
2 exhibits, which are labeled RIAA Exhibits 205 through  
3 209. We've bound them together just we don't have to  
4 hand them out individually. When you get a chance to  
5 just page through them just let me know.

6 (Whereupon, the above-referred  
7 to documents were marked as RIAA  
8 Exhibit Nos. 205-209 DPX for  
9 identification.)

10 MR. JOSEPH: I'm sorry, let him know what?

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1 MR. WINTERS: When you've had a chance to  
2 page through them.

3 MR. JOSEPH: Thank you.

4 BY MR. WINTERS:

5 Q Have you had a chance to look at RIAA  
6 Exhibits 205 through 209 DPX?

7 A Not yet. Mine seems to go from 205 to  
8 208. Wait a second, there's 207, there's 206. Okay.  
9 I see them all.

10 Q Okay. Can you just identify what those  
11 are, what Exhibits 205, 206, 207, 208, and 209 DPX  
12 are?

13 A They appear to be -- 205 appears to be a  
14 press release.

15 Q Press release of Salem Communications.

16 A Yes. I wanted to make sure that it didn't  
17 have any changes. You know, I can only tell you that  
18 it appears to be a press release from Salem.

19 Q And all of the exhibits --

20 A In every case.

21 Q They're all quarterly earnings press  
22 releases?

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1 A Yes.

2 Q Just directing your attention to the first  
3 one, which is 205 DPX, which reads at the top, "Salem  
4 Communications Announce Record Second Quarter 2001  
5 Results;" do you see that?

6 A Yes.

7 Q If I could direct your attention to --  
8 there's a line that says, "Second Quarter Results" on  
9 the first page --

10 A Yes.

11 Q -- about halfway down the page; do you see  
12 that?

13 A Yes.

14 Q And it says that net broadcasting revenue  
15 increased 36.7 percent to \$33.9 million, from -- do  
16 you see that?

17 A I do.

18 Q And that was an increase of -- I'm sorry,  
19 that was an increase of 36.7 percent from the quarter  
20 the year previous, correct?

21 A Correct.

22 Q And revenues were \$33.9 million, up from,

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1 say, \$24.8 million; is that correct?

2 A Correct.

3 Q And if you look a little bit farther down,  
4 there's the third paragraph from the bottom, it  
5 starts, "EBITDA."

6 A Yes.

7 Q It states that, "EBITDA, including the  
8 Company's non-broadcast media businesses increased to  
9 \$8.9 million in the second quarter of 2001."

10 A Correct.

11 Q Do you see that? Okay. And if you look  
12 at the third paragraph, it states that -- there's a  
13 quote from Mr. Atsinger; do you see that?

14 A Mr. Atsinger, I do.

15 Q Yes. And who's Mr. Atsinger?

16 A He's the Chief Executive Officer.

17 Q And he states in this quote, "Our long-  
18 term outlook is also very positive. Our 11 stations  
19 were recently launched -- with recently launched music  
20 formats have continued to improve their ratings  
21 performance, and we are pleased with our progress to  
22 date." Do you agree with that statement?

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1           A       I do. I would like to qualify because  
2           you've not gotten yet to the next page which talks  
3           about the acquisitions. We spent \$178 million to buy  
4           seven Clear Channel stations last year in the forced  
5           divestiture of those stations, and that's a  
6           significant factor in the increase in EBITDA and  
7           revenue.

8           Q       You spent \$178 million for how many  
9           stations?

10          A       Seven, I believe. I can think through and  
11          tell you, seven or eight.

12          Q       And your revenues and earnings have gone  
13          up since you've acquired those stations.

14          A       Yes. When we went public in 1999, we had  
15          46 radio stations; we now have 85.

16          Q       If you look at the second full paragraph  
17          on that first page, it states that -- again, there's  
18          a quote from Edward G. Atsinger. Do you see that  
19          quote?

20          A       I do.

21          Q       And it states that, "Our strong second  
22          quarter results highlight the strength of our unique

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1 business model."

2 A Correct.

3 Q "Our second quarter same station revenues  
4 increase of -- same station revenue increase of 10.5  
5 percent demonstrates Salem's ability to deliver strong  
6 results in a challenging economic environment." Do  
7 you see that?

8 A I do indeed.

9 Q The challenging economic environment being  
10 -- do you know what that's a reference to?

11 A Yes, I do. It's a reference to a downturn  
12 in advertising. And when he's referring to our unique  
13 business model, he's talking about a significant  
14 portion of our revenue coming from block programmers.

15 Q Okay. If you could just look at the next  
16 exhibit, which is Exhibit 206 DPX. I just want to go  
17 through these really quickly. It states -- the  
18 headline of that one says, "Salem Communications  
19 Announces Record First Quarter 2001 Results."

20 A Okay.

21 Q Do you see that?

22 A I do.

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1 Q And if you go to Exhibit 207 DPX, the  
2 headline of that one reads, "Salem Communications  
3 Announces Record Fourth Quarter Results."

4 A Correct.

5 Q And if you go to the next exhibit, it  
6 reads, "Salem Communications Announces Record Third  
7 Quarter 2000 Results."

8 MR. JOSEPH: Are you suggesting there's a  
9 pattern to the headlines?

10 BY MR. WINTERS:

11 Q Do you see that?

12 A I do indeed.

13 Q And the last exhibit the headline of it  
14 reads, "Salem Communications Announces Record Second  
15 Quarter 2000 Results." Is that what it reads?

16 A It does.

17 Q And it's consistent with your  
18 understanding that you've had record results for each  
19 of those quarters.

20 A Correct.

21 MR. WINTERS: I'd move the admission of  
22 Exhibits 205 through 209 DPX.

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1 MR. JOSEPH: Subject to inquiring as to  
2 the headline writer's identity, I have no objection.

3 (Laughter.)

4 CHAIRMAN VAN LOON: They're all admitted.

5 (Whereupon, the above-referred  
6 to documents, previously marked  
7 as RIAA Exhibit Nos. 205-209 DPX  
8 for identification, were  
9 admitted into evidence.)

10 THE WITNESS: I feel obliged to comment  
11 that in virtually every -- in every news release, you  
12 will find that there's a reference to our unique  
13 business model, which is what I've been describing  
14 here, the top teaching stations.

15 BY MR. WINTERS:

16 Q If you could refer to your written  
17 testimony, I'd like to refer you to page 4 and  
18 paragraph 7, 7(c), I guess it would be.

19 A Okay.

20 Q The first line of paragraph 7(c) reads,  
21 "On most religious stations music is not a driving  
22 force or featured element." Do you see that?

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1 A I do.

2 Q And also if you turn to the next page, on  
3 7(d), it reads that, "When recorded music is sold it  
4 typically is for a secondary purpose" -- oh, "When  
5 recorded music is used it typically is for a secondary  
6 purpose, such as to fill for time that has not been  
7 sold. Overall, it has considerably less value for  
8 these stations than for music-intensive stations,  
9 though of course individual stations may vary." Is  
10 that what it reads?

11 A Correct.

12 Q Your statement in paragraph 7(a) about  
13 most religious stations not using music intensively,  
14 that's changing; isn't that correct?

15 A We have -- as a company, we have more  
16 music stations than we did a year ago, certainly.

17 Q And if you look at Exhibit 204 DPX, which  
18 is your annual report, can you turn to page 5 of that  
19 annual report? It's right up in the corner of your  
20 desk there.

21 A Oh. Okay.

22 Q If you look at the bottom right of that

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1 page, the last paragraph on page 5, if you look to the  
2 sentence that starts, "Our strategy."

3 A Yes.

4 Q It reads, "Our strategy of developing  
5 Christian music radio stations represents our single  
6 largest growth initiative for the next several years."  
7 Do you see that?

8 A I do.

9 Q And it is -- developing Christian music  
10 stations is one of Salem's largest growth initiatives?

11 A May I read the previous sentence?

12 Q Sure.

13 A "It is because of the success of our  
14 foundational format and our commitment to further its  
15 success that we built two new formats: The Fish, a  
16 contemporary Christian music format, and conservative  
17 news talk. Both of these formats are consistent with  
18 our strategy of delivering compelling content to our  
19 audience, the radio listener interested in religious  
20 and family issues."

21 Q Correct. But your single largest  
22 strategic growth initiative is to introduce more

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1 Christian music radio stations.

2 A The largest new growth initiative.

3 Q And the next sentence reads, after the  
4 sentence that talks about growth initiative reads, "We  
5 are very pleased with the early ratings success of  
6 these new stations and are confident that this  
7 initiative will provide us strong financial success  
8 over the coming years." Do you see that?

9 A Yes.

10 Q And that's still the current view of the  
11 Company?

12 A I believe so.

13 CHAIRMAN VAN LOON: While we're on that  
14 paragraph, could I just ask you about, in the sentence  
15 you just read, those two names. The Fish? Could you  
16 explain the connection to the contemporary Christian  
17 music format?

18 THE WITNESS: The Fish is simply a name  
19 for the contemporary Christian music format, and we've  
20 rolled out Fish stations in Los Angeles, Atlanta,  
21 Chicago, Cleveland, and Sacramento. And it's just a  
22 name, it's a brand that we call our music format.

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1 CHAIRMAN VAN LOON: Why didn't you call it  
2 the Mackerel?

3 THE WITNESS: Well, the Fish is the  
4 ancient symbol of Christianity, and there's a tie-in  
5 with our core audience who follow us for the other  
6 content that we deliver. Believe me, there have been  
7 a lot of jokes about it and a lot of suggestions.

8 CHAIRMAN VAN LOON: What about the second  
9 one, conservative news talk?

10 THE WITNESS: We found a number of years  
11 ago that when our listeners leave us they typically go  
12 to a conservative news talk station. They go listen  
13 to Rush Limbaugh or Dr. Laura, somebody like that.

14 CHAIRMAN VAN LOON: So it's politically --

15 THE WITNESS: So we have developed our own  
16 conservative family issues format, some of which is  
17 political, some of which is family issues, counseling,  
18 marriage, family, that kind of thing.

19 CHAIRMAN VAN LOON: And you would more or  
20 less equate Salem's religious broadcasting with  
21 conservative politics? Is that the inference?

22 THE WITNESS: No, I don't believe that

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1 necessarily follows. Many of our listeners go to a  
2 conservative station. With most radio, I think  
3 everybody found conservative politics on the radio  
4 worked better during the Clinton Administration than  
5 it does during the Bush Administration. It's always  
6 nice to be somewhat in opposition, but conservative in  
7 terms of family values and moral issues, certainly.

8 BY MR. WINTERS:

9 Q Mr. Davis, would you agree that much of  
10 Salem's spot advertising growth is due to the  
11 introduction of these Christian music format stations?

12 A I don't see evidence of that yet. I hope  
13 that grows.

14 Q We'd like to hand out --

15 A Those are all new stations.

16 Q We'd like to hand out what's been marked  
17 as RIAA Exhibit 210 DPX.

18 (Whereupon, the above-referred  
19 to document was marked as RIAA  
20 Exhibit No. 210 DPX for  
21 identification.)

22 BY MR. WINTERS:

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1           Q       You've had a chance to review Exhibit 210  
2       DPX? Can I just direct your attention to the second  
3       page of Exhibit 210 DPX? Oh, and just for the record,  
4       Exhibit 210 DPX is a copy of an article from the Los  
5       Angeles Business Journal on January 29, 2001. Do you  
6       see that?

7           A       I do.

8           Q       Referring again to the second page, sort  
9       of the bottom of that page --

10          A       Yes.

11          Q       -- there's a reference to a quote from a  
12       man named Evans; do you see that?

13          A       I do.

14          Q       Do you know who Evans would be? Is that  
15       David Evans, Salem's Chief Financial Officer?

16          A       It is.

17          Q       And the quote reads, "Our spot advertising  
18       sales -- our, in parentheses, spot advertising sales,  
19       will gradually increase over the next few years,  
20       because we have launched a number of music and talk  
21       stations that are 100 percent driven by advertising."

22          A       Correct.

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1 Q And that's a correct statement?

2 A Yes, it is.

3 Q And if you would --

4 A Again, I call your attention to the fact  
5 that I'm not here to testify about music-intensive  
6 stations. My concern is the non-music-intensive  
7 stations, and certainly, as he mentions talk stations  
8 there, I would be happy to comment on that.

9 Q Okay. And if you look at the next  
10 paragraph, it reads, "Much of that spot advertising  
11 growth is being attracted by Salem's contemporary  
12 Christian music format, essentially a light rock with  
13 a religious message targeted to a young audience." Is  
14 that also a correct statement?

15 A That doesn't appear to be a quote to me.  
16 It looks like that was something that the author of  
17 the article said.

18 Q Well, would you agree with it?

19 A "Much of that spot advertising growth is  
20 being attracted by Salem's contemporary Christian  
21 music format." I would think that we would certainly  
22 hope that it's going to grow, sure, sure. Paid a lot

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1 of money for those radio stations.

2 Q If we could go back to your written  
3 testimony, paragraph 12, which goes from -- I think  
4 carries over from page 6 to 7.

5 A Okay.

6 Q There's a reference to the fact that -- or  
7 the testimony states, "Record companies and musicians  
8 whose products appeal to those who listen to religious  
9 radio long have recognized that having their music  
10 played on such stations, including stations that do  
11 not generally feature music, has great promotional  
12 value." Do you see that statement?

13 A Yes.

14 Q And that's your testimony today as well.

15 A Yes.

16 Q Would religious radio stations that play  
17 music be the same as other stations that play music in  
18 this regard?

19 A Well, no, because they don't play music.

20 Q Let me rephrase that.

21 A Okay.

22 Q Would religious and Christian-oriented

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1 stations that play music have the same promotional  
2 benefit to the people who record that music as other  
3 non-religious and non-Christian radio stations that  
4 play music?

5 A Well, we ask our employees of non-music  
6 stations to sign payola/plugola agreements just like  
7 we ask employees of music stations. Apart from any  
8 legal reason that might require that, another reason  
9 is that because music is artist-driven, sometimes when  
10 these artists come to town our talk teaching stations  
11 are asked to interview -- they typically have talk  
12 shows -- they're asked to interview these performers,  
13 because maybe they've written a book or something like  
14 that, and they hope to get some value out of it. So,  
15 indeed, our talk teaching stations are vulnerable to  
16 that to a lesser degree but just as our music stations  
17 are.

18 Q I guess probably the simplest statement  
19 I'd ask you to agree with is do you agree that there's  
20 no less promotion of music due to the fact that it's  
21 Christian music, is that correct, as opposed to other  
22 forms of music?

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1           A       I would have no idea. I've never been  
2 involved with other forms of music.

3           Q       Okay. So you can't compare the  
4 promotional value of playing Christian music on your  
5 stations versus playing other types of music on other  
6 stations.

7           A       I don't have general marketing experience.  
8 My experience has been with the news broadcasting. As  
9 an advertising agency, I didn't get into that. I do  
10 know that it's significant, even on the talk teaching  
11 stations, because we do have people that hesitate  
12 before they sign those payola/plugola agreements.

13          Q       Okay. Let's explore for a minute the  
14 promotional value of Salem's radio operations. Salem  
15 recently opened a Christian music radio station in  
16 Chicago, Illinois?

17          A       Correct.

18          Q       And that's -- I think it's 96.7, the Fish?

19          A       I believe so. There are a lot of call  
20 letters to remember and a lot of frequencies, but if  
21 you say so, I will -- that sounds reasonable.

22          Q       And before Salem began the operations of

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1 the Fish in Chicago there were no Christian music  
2 radio stations in Chicago?

3 A None that covered the full market. I'm  
4 not aware of any.

5 Q I'd like to hand out what we'll mark as  
6 Exhibit 211 DPX.

7 (Whereupon, the above-referred  
8 to document was marked as RIAA  
9 Exhibit No. 211 DPX for  
10 identification.)

11 Q You've had a chance to review 211 DPX?

12 A Yes.

13 Q Can you identify it for the record?

14 A It's a press release announcing the launch  
15 of our music station, all music station in Chicago,  
16 WZFS-FM, the Fish.

17 Q And that's a press release of Salem  
18 Communications, correct?

19 A It is.

20 Q I'd like to direct your attention to the  
21 third paragraph of the first page of 211 DPX. It  
22 starts with a quote, "The Chicago area is the number

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1 three market for Christian music sales, but there's  
2 been a huge void in reaching the audience through  
3 radio." Do you see that?

4 A I do.

5 Q Is that your understanding of the Chicago  
6 market before the Fish was introduced?

7 A I have to tell you, frankly, I don't know,  
8 and Mr. Timm is no longer with the station.

9 Q But in your testimony, at the beginning,  
10 I thought you had testified that you still have  
11 primary responsibilities for a number of markets.

12 A I do.

13 Q And Chicago's not one of them?

14 A No, it's not.

15 Q If you look at the next --

16 A I do know that Chicago has an  
17 extraordinary of religious bookstores, higher than  
18 most other cities. I don't know if that influences it  
19 or not, and I don't know where this quote came from or  
20 where the information came from. I would only tell  
21 you that Mr. Timm doesn't run that radio station.

22 Q But it is a press release of your Company.

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1 A And we're quoting an employee.

2 Q Okay. And --

3 A Who was responsible for that market.

4 Q So he would know about the Chicago radio  
5 market.

6 A I don't know.

7 Q If that statement is true in the press  
8 release, that there was a void in reaching the  
9 audience in Chicago, I guess the Chicago audiences  
10 wouldn't be listening to a lot of Christian music  
11 radio -- Christian music over the radio in Chicago as  
12 well, correct?

13 MR. JOSEPH: I object to the form and to  
14 the fact that it's calling for speculation on the  
15 basis of a hypothetical that the Witness has testified  
16 that he didn't have knowledge of.

17 MR. WINTERS: I can rephrase.

18 CHAIRMAN VAN LOON: I think that would be  
19 a good idea.

20 BY MR. WINTERS:

21 Q If there was a void in the market for  
22 reaching the audience of Christian music radio fans,

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1       there probably wasn't a lot of Christian music being  
2       played over the radio in Chicago; is that correct?

3               A       Same objection, plus lack of foundation  
4       since the Witness has testified that he doesn't know  
5       whether in fact there was a void.

6               CHAIRMAN VAN LOON: Overruled. That means  
7       you can go ahead and answer.

8               ARBITRATOR VON KANN: If you can.

9               THE WITNESS: Could you restate the  
10       question again? I'm sorry, I've lost it now.

11              BY MR. WINTERS:

12              Q       If there was a void in the market for  
13       reaching the audience of people who buy Christian  
14       music over the radio, it stands to reason that there  
15       wasn't a lot of Christian music being played over the  
16       radio, correct?

17              A       Well, I can assure you there's more now  
18       than there was before.

19              Q       And Chicago was the number three market  
20       for Christian music sales without a Christian music --  
21       with there being a void in reaching the audience for  
22       people who buy Christian music; isn't the correct?

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1 MR. JOSEPH: Objection.

2 THE WITNESS: I don't know the source of  
3 that.

4 MR. JOSEPH: He beat me to the punch.

5 CHAIRMAN VAN LOON: Sustained.

6 BY MR. WINTERS:

7 Q Isn't it true that before you launched the  
8 Fish in Chicago that it was already a big market for  
9 Christian music sales?

10 A Again, I'm not qualified. I can tell you  
11 there a lot of Christian bookstores around Chicago.

12 Q Okay. Let's move on to a market which you  
13 should be a little bit more familiar.

14 ARBITRATOR VON KANN: A question on that:  
15 Do Christian bookstores tend to also carry records?

16 THE WITNESS: It's my understanding that  
17 they do.

18 MR. WINTERS: I'd like to hand out what's  
19 been marked as RIAA Exhibit 213 DPX -- I'm sorry, 212  
20 DPX.

21 (Whereupon, the above-referred  
22 to document was marked as

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Exhibit No. 212 DPX for  
identification.)

BY MR. WINTERS:

Q You've had a chance to review 212 DPX?

A Yes.

Q And 212 DPX is another press release from  
Salem Communications?

A Yes.

Q And Atlanta is one of the markets you're  
familiar with?

A Yes.

Q And that's because you still have primary  
responsibility for that market?

A Yes.

Q And this press release concerns the launch  
of a contemporary Christian station in Atlanta called  
the Fish as well?

A Yes.

Q If you look at the second paragraph of 212  
DPX, it reads, "The 100,000-watt WFSH-FM, the new  
104.7, the Fish, becomes the first station to fully  
cover the number 11 Atlanta market with the

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1 increasingly popular contemporary Christian music  
2 format." Do you see that?

3 A Yes.

4 Q Is it your understanding that no station  
5 full covered the Atlanta market before the  
6 introduction of the Fish? No Christian music station.

7 A I would qualify that by saying no stations  
8 signal geographically fully covered the Atlanta  
9 market. There is a Christian station on the other  
10 side of town that covered part of the market that  
11 consistently got ratings in the two and a half to  
12 three range.

13 Q But it didn't cover the entire Atlanta  
14 market.

15 A Those are market ratings.

16 Q And if you look to the next paragraph, I  
17 refer you to the last sentence in that paragraph,  
18 which reads, "Atlanta is the eighth largest market in  
19 the United States for contemporary Christian music and  
20 is a regular tour stop for many of the top artists in  
21 Christian music. So we know there is an enormous  
22 audience that is excited about our arrival in this

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1 market." Do you see that statement?

2 A Correct.

3 Q And that's a correct statement?

4 A Correct.

5 Q So Atlanta is the number 11 overall market  
6 for radio in the nation, is that correct, reading the  
7 previous paragraph?

8 A Yes.

9 Q But it's the number eight -- it's the  
10 eighth largest market for contemporary Christian  
11 music?

12 A Correct.

13 Q And it became the eighth largest market  
14 for contemporary Christian music before it was fully  
15 covered by a Christian music station?

16 A It became the eighth largest --

17 Q Market for --

18 A -- market before it was covered by our  
19 station.

20 Q And before your station was introduced the  
21 Atlanta market was not fully covered by a Christian  
22 music station.

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1           A       Geographically. You know, you'd have to  
2 talk to a ratings expert as to whether a two and a  
3 half or three share is fully covered. Some would  
4 consider that yes, some would consider it no.

5           Q       If I could just refer you back to Exhibit  
6 204 DPX, which is Salem's annual report.

7           ARBITRATOR VON KANN: Before we leave this  
8 exhibit, can I just ask the Witness do you know, since  
9 this is the Salem press -- in what sense the reference  
10 is made to Atlanta as the number 11 market? Is that  
11 in number of listeners, is it in sales? In what way  
12 is it the number 11 market?

13          THE WITNESS: It's the number 11 market  
14 rates by Arbitron in terms of number of available ears  
15 to listen to radio.

16          ARBITRATOR VON KANN: Okay. Thank you.

17          MR. WINTERS: Before I move on, I move the  
18 admission of 211 and 212 DPX.

19          CHAIRMAN VAN LOON: Both 211 and 212?

20          MR. WINTERS: That's correct.

21          CHAIRMAN VAN LOON: Two press releases.  
22 Any objection?

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1 MR. JOSEPH: No objection.

2 CHAIRMAN VAN LOON: Admitted.

3 (Whereupon, the above-referred  
4 to documents, previously marked  
5 as RIAA Exhibit Nos. 211 and 212  
6 DPX for identification, were  
7 admitted into evidence.)

8 BY MR. WINTERS:

9 Q Once again, I refer you back to the annual  
10 report, on page 8 of the annual report. If you look  
11 at the second paragraph, there's a bold headline, "The  
12 Fish contemporary Christian music." Do you see that  
13 paragraph?

14 A I do.

15 Q Referring to the second sentence in that  
16 paragraph, it reads, "Christian music in terms of  
17 album sales has grown by an average of 16 percent over  
18 the past ten years and now represents the sixth  
19 largest music genre." Is that your understanding as  
20 well?

21 A I don't know where that came from, but  
22 that is my understanding, correct.

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1           Q     And before Salem started its strategic  
2 growth initiative to introduce more Christian music  
3 stations into its markets, that growth would have to  
4 be explained by something other than Salem increasing  
5 the amount of Christian music radio stations in the  
6 markets, correct?

7           A     Prior to our doing that.

8           Q     And isn't it true that actually the  
9 popularity of Christian music, evidenced by the growth  
10 in sales, it actually is what drove Salem  
11 Communications into the markets for Christian music  
12 radio.

13          A     It was one consideration.

14          Q     Right. And if you look at the next  
15 sentence, it reads, "In response to this demand, we  
16 have launched stations with the Fish format in a  
17 number of cities, including Dallas, Atlanta, Los  
18 Angeles, Chicago, and shortly Cleveland." Do you see  
19 that statement?

20          A     Correct.

21          Q     And you have launched into Cleveland?

22          A     We have.

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1 CHAIRMAN VAN LOON: I'm sorry, which page

2 --

3 MR. WINTERS: I'm sorry, we're still on  
4 page 8.

5 CHAIRMAN VAN LOON: Still, okay.

6 BY MR. WINTERS:

7 Q And the next line reads, "This music is a  
8 major attraction to general market advertisers due to  
9 its ability to draw listeners from all walks of life."  
10 And that's consistent with your understanding?

11 A Correct.

12 Q I just have one -- a couple additional  
13 questions. You stated the primary purpose of your  
14 testimony is to explain why the outcome of this  
15 proceeding must take into account stations that use  
16 less music than music-intense stations; isn't that  
17 correct?

18 A Correct.

19 Q And I take you're aware that the RIAA is  
20 offering a per performance rate for webcasting and  
21 simulcasting?

22 A I'm really not familiar in any detail with

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1 what the RIAA is offering.

2 Q Besides the \$5,000 minimum that you spoke  
3 about in your testimony.

4 A Well, I didn't speak of the \$5,000; I  
5 spoke of the 250.

6 Q Okay. I thought you also spoke about the  
7 \$5,000 minimum that you understand to be offering by  
8 the RIAA.

9 A That was a question? Yes, I think the  
10 question was asked.

11 Q Are you aware that there's a 0.4 cent per  
12 performance rate that's being offered by the RIAA?

13 A You know, I've seen the number 0.4. I  
14 don't have a real good understanding of what per  
15 performance means.

16 Q Well, in Salem Communications' own  
17 proposed rates and terms, you offer a per performance  
18 rates; isn't that correct?

19 A We offer a per performance rate to whom?

20 Q As payment of royalties for the use of  
21 sound recordings streamed over the Internet.

22 A Has Salem Communications offered that?

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1 Q Well, I'd like to refer you to Exhibit, I  
2 believe -- or your proposed rates and -- do you have  
3 the proposed rates and terms --

4 A No, I don't.

5 Q -- in front of you?

6 A No.

7 ARBITRATOR VON KANN: Exhibit B to his  
8 testimony?

9 BY MR. WINTERS:

10 Q Yes. I think it's Exhibit B to your  
11 testimony.

12 A I don't have that with me. Could I see  
13 it?

14 ARBITRATOR VON KANN: Can you supply one  
15 to your Witness?

16 MR. JOSEPH: I don't have it immediately  
17 with me.

18 MR. GARRETT: I have a copy.

19 THE WITNESS: This doesn't indicate that  
20 it's an exhibit to my testimony.

21 BY MR. WINTERS:

22 Q We pulled it out of the book that includes

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1 your testimony as attached thereto. It appears you  
2 probably don't have all the exhibits to your testimony  
3 in front of you; is that correct?

4 A I don't have this one nor does it indicate  
5 that it's an exhibit to my testimony.

6 CHAIRMAN VAN LOON: Well, it is. We've  
7 all received from your lawyer with that attached as  
8 Exhibit B, so we have that common understanding.

9 ARBITRATOR VON KANN: It's an exhibit to  
10 your case; it may not be to your testimony. There's  
11 a slight distinction, but it was in the package that  
12 your lawyers put together.

13 MR. JOSEPH: And it's referenced in the  
14 cover letter as adjoining the proposed rates that were  
15 jointly developed by the Webcaster/Broadcaster  
16 parties, a copy of which is attached as Tab B. It's  
17 not at all referenced in his testimony.

18 BY MR. WINTERS:

19 Q Have you ever seen this document before?

20 A I can't say that I've seen this exact  
21 document. I've seen some things that are in it, I  
22 guess.

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1           Q       Can I just direct your attention to the  
2 first page and paragraph, I guess it's 1(a)(2). It  
3 says, "0.00014 times the number of compensable sound  
4 recording performances by the service." Do you see  
5 that? And that's a reference to a rate that takes  
6 into account -- or not so much takes into account but  
7 allows people who stream music over the Internet to  
8 pay on a per performance basis; is that correct?

9           A       I don't know.

10          Q       Okay.

11          A       You're telling me.

12          Q       Is the concept of paying per performance  
13 of the music that is streamed acceptable to Salem  
14 Communications as a concept?

15          A       We do have per performance licenses with  
16 ASCAP/BMI.

17          Q       And because you use music less  
18 intensively, you would request a per performance rate.

19          A       We did request a per performance rate with  
20 ASCAP/BMI in some circumstances.

21          Q       Instead of a blanket rate.

22          A       Correct.

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1           Q       And in as much as the RIAA proposes a per  
2 performance rate as well, that would be acceptable,  
3 given the fact that you probably don't agree with the  
4 actual rate level set, but the concept of a per  
5 performance rate is something you agree with.

6           A       We do support a model that uses the  
7 ASCAP/BMI model.

8           Q       That's it. I have no further questions.  
9 Thank you very much, Mr. Davis.

10           MR. JOSEPH: May I have a moment to  
11 consult with my colleagues?

12           CHAIRMAN VAN LOON: Please. Let's take a  
13 two-minute break.

14                   (Whereupon, the foregoing matter went off  
15 the record at 10:22 a.m. and went back on  
16 the record at 10:28 a.m.)

17           CHAIRMAN VAN LOON: And is the verdict in,  
18 Mr. Joseph?

19           MR. JOSEPH: I have one or two questions.

20           CHAIRMAN VAN LOON: Sure.

21                   REDIRECT EXAMINATION

22           BY MR. JOSEPH:

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1           Q       Yes. Mr. Davis, at the very end of your  
2 cross examination, you commented that you believed the  
3 Salem stations had a, quote, "per performance," closed  
4 quote, license with ASCAP and BMI. As you've had an  
5 opportunity to reflect on that, was that an accurate  
6 statement?

7           A       No, it wasn't. I get confused with the  
8 terminology. It's a per program license, not a per  
9 performance license that we have.

10          Q       Okay. I just wanted to set the record  
11 straight on that, and I have no further --

12          A       And a program, as I understand it, is a  
13 period of time.

14          Q       I have no further questions on redirect.

15                 ARBITRATOR VON KANN: Can you just explain  
16 that last one a little bit, when you say it's on a per  
17 program basis; that is, does ASCAP look at the  
18 particular program and say, "Well, there's a lot of  
19 songs or not very many songs, and here's" -- how does  
20 that work? I guess I don't quite understand what that  
21 means. If you know, and if you don't, that's fine.

22                 THE WITNESS: I think what I know is that

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1 if there are any songs, we pay a royalty for that  
2 period of time. And I don't recall what the period of  
3 time is, whether it's a quarter hour, half hour or an  
4 hour.

5 ARBITRATOR VON KANN: Okay. All right.  
6 I have one other. If you could look at your direct  
7 testimony, Mr. Davis. On page 4, you -- the top of  
8 the page, actually, the first full sentence says, "The  
9 typical manner of operation of religious stations  
10 differs from typical conventional radio stations in  
11 the following respects," and then you list a number of  
12 them, A through E, I guess, five, I suppose. The  
13 first one of which is that as a rule the primary  
14 source of revenue for these stations is the sale of  
15 blocks of airtime, typically quarter hour, half hour,  
16 and hour, to various ministries who present  
17 programming of their choice." Do you see that?

18 THE WITNESS: I do, sir.

19 ARBITRATOR VON KANN: And that's  
20 consistent with what you've testified to here today.  
21 And I guess my question is this: Isn't it likely,  
22 given that modus operandi, that whatever royalty this

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1 Panel sets you're simply going to pass on to your  
2 programmers?

3 THE WITNESS: I wish that were the case.  
4 The amount of money we charge for our airtime is not  
5 calculated based on our expenses. Those kinds of  
6 expenses are clearly the responsibility of the  
7 licensee. We sell these programs based on the value  
8 to the advertiser, whether it's a block advertiser or  
9 a spot advertiser. And because they are developing a  
10 constituency in our marketplaces that we serve, the  
11 only thing that really allows them to pay a greater  
12 amount of money is if we can produce more listeners,  
13 more ears that also generate more response. So I  
14 don't know of any of them that would be responsive if  
15 we went to them and said, "Our expenses have risen."

16 ARBITRATOR VON KANN: Well, as I  
17 understood your testimony, some of your programmers  
18 use a fair bit of music and some use hardly any at all  
19 in their programs; is that right?

20 THE WITNESS: I would not say a fair bit  
21 of music. I would say from none to very little. I  
22 don't know of any that use music as a program element.

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1                   ARBITRATOR VON KANN:   And you didn't  
2 discuss this, and we don't need to go into any  
3 details, but when you say you sell blocks of time to  
4 these ministries, I suppose you have some kind of a  
5 rate structure or sale structure or whatever it is to  
6 sell those blocks of time.

7                   THE WITNESS:   We do.

8                   ARBITRATOR VON KANN:   Would that not take  
9 account of whether or not a program was using any  
10 sound recordings that would give rise to some royalty  
11 obligations?       I mean you wouldn't anticipate  
12 distinguishing in that schedule between the programmer  
13 who uses no sound recordings and therefore is not  
14 increasing your royalty obligation at all versus the  
15 one who is.

16                  THE WITNESS:   I've never seen that  
17 distinction. I've never heard it discussed. It would  
18 be an interesting discussion to have with our clients.  
19 I can't imagine that they would be interested in  
20 hearing that any of our expenses have risen and that  
21 we were passing them on.

22                  ARBITRATOR VON KANN:   Is there any

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1 distinction at the moment between -- I mean you'd have  
2 the same issue, I guess, or might with respect to  
3 ASCAP/BMI royalties. Some of your programmers aren't  
4 playing any music and therefore not giving rise; some  
5 are. Has there been any attempt up to now in any way  
6 to factor that into the charges that you make to those  
7 different programmers?

8 THE WITNESS: Not with Salem  
9 Communications and to my knowledge not with anybody  
10 else in the industry.

11 ARBITRATOR VON KANN: So you would expect  
12 that Salem, for example, whatever royalties may be  
13 assessed here, that Salem would simply pick those up  
14 as general operating expenses to be deferred in some  
15 fashion, whether through increased advertising revenue  
16 or some other way; is that right?

17 THE WITNESS: Correct.

18 ARBITRATOR VON KANN: Okay.

19 CHAIRMAN VAN LOON: Mr. Davis, I had a  
20 couple things I wanted to ask you about also. In your  
21 testimony, on page 8, down toward the bottom, in  
22 paragraph 17, you're talking about the non-commercial

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1 stations, and that second sentence says, "In many ways  
2 their economies are comparable to National Public  
3 Radio stations and should be eligible for the same  
4 reduced royalties commonly afforded to NPR stations."  
5 What sort of a reduction do the NPR stations get?

6 THE WITNESS: I don't know. I was  
7 speaking with an overview here, and I don't know what  
8 that reduction is.

9 ARBITRATOR GULIN: You're speaking of the  
10 royalties that would be given to NPR by this Panel; is  
11 that what you mean?

12 THE WITNESS: To the extent that national  
13 -- I guess I was drawing a similarity between National  
14 Public Radio, also a non-profit, and these  
15 organizations which are non-profit, many of them much  
16 smaller than any of the NPR stations I'm familiar  
17 with. But to the extent that NPR stations might be  
18 eligible for some sort of a special rate, I certainly  
19 think that these people should be too.

20 CHAIRMAN VAN LOON: You mean a special  
21 rate possibly given by this Panel or special rates  
22 that they receive now in other context?

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1 THE WITNESS: Either. Either or both.

2 CHAIRMAN VAN LOON: Do you have any  
3 knowledge at all about reduced royalties that are  
4 commonly afforded to NPR stations, to use the words  
5 here in your -- I'm trying to understand what the  
6 words in your testimony mean.

7 THE WITNESS: Well, I'm speaking  
8 philosophically, and I guess I'm under the impression  
9 that they do receive reduced royalties from ASCAP/BMI.  
10 I don't know what those are. I'm not familiar with  
11 them. I'm just drawing a similarity between the type  
12 of radio station as compared with a regular commercial  
13 radio station that's music intensive.

14 CHAIRMAN VAN LOON: Am I remembering  
15 correctly you were -- do you know what kind of a  
16 discount NPR gets from ASCAP/BMI?

17 THE WITNESS: No, I do not. I do not.

18 CHAIRMAN VAN LOON: And I believe you  
19 testified earlier this morning about appropriate, I  
20 think was your word, appropriate reduced rates from  
21 ASCAP/BMI for your stations.

22 THE WITNESS: Or stations that are part of

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1 the NRBMLC.

2 CHAIRMAN VAN LOON: Yes.

3 THE WITNESS: Rates that more accurately  
4 reflect the limited use of music.

5 CHAIRMAN VAN LOON: And are those  
6 generally ten percent discount or 25 percent? How do  
7 their rates reflect?

8 THE WITNESS: I apologize that I don't  
9 know because I came into this in 1089 mid-stream, so  
10 I don't know what rates the other stations pay. I'm  
11 just not familiar with the differential.

12 CHAIRMAN VAN LOON: But you do know for a  
13 fact that they pay different lower rates.

14 THE WITNESS: I know they pay different  
15 with rates that more fairly reflect the different use  
16 of music.

17 CHAIRMAN VAN LOON: But you have no  
18 concept whatsoever about how they more fairly reflect,  
19 what that translates into in practical terms.

20 THE WITNESS: I apologize, but I honestly  
21 do not.

22 CHAIRMAN VAN LOON: Okay. I wanted to ask

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1       you about one other thing, if I could -- your  
2       Company's annual report. On page 4, which is the  
3       overview summary from your President and Chairman, you  
4       all may have done something which is not typical. In  
5       the second paragraph there at the very end, there's a  
6       sentence that says, "We have substantially reduced the  
7       cost base of our Internet business, and we expect to  
8       reach profitability in the fourth quarter of 2001."  
9       As far you know, as the Senior Vice President for  
10      Operations, are you on target to reach profitability  
11      for your Internet operations fourth quarter this year?

12               THE WITNESS:     I'm the Senior Vice  
13      President for operations of the Radio Station  
14      Division, but it is my understanding that we are on  
15      target to reach profitability for our other media  
16      division, which includes magazines and Internet.

17               CHAIRMAN VAN LOON:   I see. But this  
18      sentence would seem to say that even within other  
19      media, if you broke out magazines and Internet, the  
20      Internet is going to reach profitability, and a  
21      quarter of it starts a month from now.

22               THE WITNESS:   I can tell you we have not

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1 changed that guidance.

2 CHAIRMAN VAN LOON: Have not.

3 THE WITNESS: Have not changed.

4 CHAIRMAN VAN LOON: So as far as you know,  
5 you're still on target to do this.

6 THE WITNESS: Correct.

7 CHAIRMAN VAN LOON: Okay. Thank you very  
8 much.

9 MR. JOSEPH: May I just explore that last  
10 point one little bit further?

11 REDIRECT EXAMINATION

12 BY MR. JOSEPH:

13 Q If you look at that paragraph, does that  
14 explain what Salem and OnePlace have done to try to  
15 move toward profitability in the one-place operation?

16 A It does not fully explain it, and what  
17 Salem has done is -- I think it does say that we've  
18 reduced the cost base, but we've also begun to receive  
19 revenues from these ministry programmers that are on  
20 our radio stations paying us to be on our Internet  
21 site. I think I referred at the beginning of my  
22 testimony to those 129 ministries that stream with us.

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1 When we first got them to come with us, we had to give  
2 them some free time just like all the Internet  
3 companies were doing during those months, thinking  
4 that numbers of hits would solve everything and that  
5 we could sell a whole lot of banner advertising.

6 We've been just like every other Internet  
7 company. We were probably overoptimistic on banner  
8 advertising, but we've not been disappointed with the  
9 response of the ministries to buy the archiving time  
10 from us on our Internet. So we do continue to plan to  
11 reach profitability by the fourth quarter, primarily  
12 on the strength of that streaming business from those  
13 ministry clients.

14 Q Thank you. I don't have anything else.

15 ARBITRATOR VON KANN: I'm sorry, but I got  
16 -- I think that series of questions prompts me to make  
17 sure I understood some earlier testimony. You said  
18 you're now receiving some money from the ministries  
19 for their Internet streaming; is that right?

20 THE WITNESS: Correct.

21 ARBITRATOR VON KANN: So they are paying  
22 something to have you stream their programs.

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1 THE WITNESS: Correct.

2 ARBITRATOR VON KANN: This brings me back  
3 to the matter we discussed earlier and suggests we  
4 might have had a misunderstanding. My notion of  
5 passing on the royalty to the programmers was with  
6 respect to the Internet, because there ain't any  
7 royalty due for the radio, you understand that. You  
8 don't have to pay any royalty to the record companies  
9 for sound recordings played on over-the-air radio.  
10 The law doesn't require that. We're talking here only  
11 about the Internet. So with respect to the Internet  
12 operations, if you are indeed charging the programmers  
13 something, would you not include in that charge the  
14 royalty fee?

15 THE WITNESS: As I understand it, we were  
16 talking about radio stations streaming on the  
17 Internet. These are not radio stations; these are  
18 people who bring us their tapes, most of whom don't  
19 have music on them anyway, and just them to archive  
20 them so that our constituents and their can reach them  
21 through the Internet. So it's not an issue  
22 necessarily related to our radio stations other than

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1 it's a nice resource to tell our radio station  
2 listeners they can go there and hear the programs.

3 ARBITRATOR VON KANN: All right. I guess  
4 my -- I don't want to prolong this too much -- my  
5 understanding from your testimony is that although you  
6 have whatever the total is, 85 or something stations,  
7 only about ten or 15 of them are streaming at this  
8 point.

9 THE WITNESS: Correct.

10 ARBITRATOR VON KANN: And then there's  
11 another two or three independents. And it is with  
12 respect to those that the royalty obligations that  
13 we're dealing with here would arise.

14 THE WITNESS: Correct.

15 ARBITRATOR VON KANN: And I guess, again,  
16 I'm wondering would it not be logical to say to those  
17 particular programmers, "Well, now that we are not  
18 only broadcasting your program over the air but it is  
19 also on the -- being streamed, that gives rise to an  
20 additional royalty payment that we would not otherwise  
21 have, and we're going to charge that to you because  
22 that's part of the cost that is now being created by

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1 streaming your program." And I guess my question is  
2 whether that would be a viable model for you to  
3 follow, do you think?

4 THE WITNESS: As I listen to you present  
5 it, I wish you could go with me to some of those and  
6 see if you were any better at convincing them of that  
7 than I was.

8 ARBITRATOR VON KANN: Okay. And then one  
9 question that prompted the Chairman's question. About  
10 this reduction for NPR, and I understand you don't  
11 know the magnitude of it, is your understanding that  
12 there may be a reduction for NPR stations because they  
13 use less music in their programming?

14 ARBITRATOR GULIN: Chairman von Kann,  
15 maybe I can shed some light on this. The royalties  
16 that are due for NPR are subject to a statutory  
17 license, and so it's set by statute, it was set by a  
18 panel, as a matter of fact, on which I served. So it  
19 is a different rate set by a compulsory license,  
20 whereas commercial radio is not subject to a statutory  
21 license so that's a -- that would be rates set by  
22 negotiations. I think he said that he doesn't really

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1 understand or know what the differential is between  
2 what the commercial rates are what non-commercial  
3 rates are.

4 ARBITRATOR VON KANN: Right. And that's  
5 the sound recording rate that you're talking about, I  
6 take it.

7 ARBITRATOR GULIN: No. I thought you were  
8 asking him about ASCAP.

9 ARBITRATOR VON KANN: Okay. Okay. Fine.  
10 Okay. Thank you.

11 CHAIRMAN VAN LOON: In that case, we thank  
12 you very much for being with us this morning and  
13 sharing this information.

14 THE WITNESS: Thank you, Your Honor.

15 CHAIRMAN VAN LOON: Is the next witness  
16 here or should we take a break?

17 MR. JOSEPH: Yes, I believe he is. Seeing  
18 the next witness' counsel, I think I can --

19 CHAIRMAN VAN LOON: Okay. Why don't we  
20 plan to take a break then until 11 -- five past?

21 (Whereupon, the foregoing matter went off  
22 the record at 10:47 a.m. and went back on

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1 the record at 11:08 a.m.)

2 CHAIRMAN VAN LOON: Ms. Aistars, will be  
3 you be proceeding with this witness?

4 MS. AISTARS: I will.

5 CHAIRMAN VAN LOON: Great. Let us welcome  
6 you to the proceeding. We appreciate your coming.  
7 Whereupon,

8 DOUGLAS G. TALLEY

9 Was recalled as a witness by Counsel for the  
10 broadcasters, and having been first duly sworn,  
11 assumed the witness stand, was examined and testified  
12 as follows:

13 DIRECT EXAMINATION

14 BY MS. AISTARS:

15 Q Good morning, Mr. Talley. Could you  
16 please identify yourself and spell your name for the  
17 record?

18 A My name is Douglas G. Talley, last name is  
19 spelled T-A-L-L-E-Y.

20 Q And who is your current employer, Mr.  
21 Talley?

22 A I'm employed by a company AEI/DMX Music.

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1 Q And what is AEI/DMX Music?

2 A It's a company that distributes music to  
3 businesses and residential subscribers worldwide. We  
4 have over 120,000 businesses worldwide that receive  
5 our music.

6 Q And has the company always been known as  
7 AEI/DMX Music?

8 A No. Prior to May of this year, DMX was a  
9 separate company in competition with another company  
10 called AEI Music. And we merged with AEI Music in  
11 May.

12 Q And what is your current position at the  
13 company?

14 A I'm the chief technical officer.

15 Q And how long have you held that position?

16 A I've had that position since 1992.

17 Q Could you please explain for the panel  
18 what responsibilities you have in this role?

19 A I'm in charge of research and development  
20 and all of the technical operations worldwide.

21 Q Before you joined DMX did you have any  
22 other experience related to background music services?

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1           A       Prior to joining DMX I was the founder and  
2 chairman of a company called Digital Radio Labs which  
3 had one of the first cable TV delivered digital music  
4 services called Digital Plan. And for a time that  
5 company was a competitor of a DMX's.

6           Q       Could you describe your educational  
7 background for the panel?

8           A       I have a degree in electrical engineer. A  
9 bachelor's degree from Penn State and a master's  
10 degree from UCLA.

11          Q       And, Mr. Talley, could you tell the panel  
12 what the purpose of your testimony here today is?

13          A       The purpose of my testimony here today is  
14 to provide the panel with an overview of how DMX  
15 programs and transmits its content to businesses. And  
16 I also will focus on how DMX uses technology to  
17 protect copyrighted content and how our technology  
18 helps copyright owners promote the sales of their  
19 sound recordings.

20          Q       Now, Mr. Talley, today we'll be focusing  
21 on your delivery of music to business establishments.  
22 So to start off, could you please identify for the

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1 panel the methods by which DMX distributes music to  
2 business establishments?

3 A We have several delivery techniques that  
4 we use. One method is by direct satellite broadcast,  
5 transmissions from satellite to small satellite on  
6 businesses.

7 We also distribute our content via cable  
8 TV network.

9 We also have a product that plays CDs that  
10 are physically mailed to the business on a monthly  
11 basis. These are special encoded and formatted CDs.

12 And we also have a product that has a hard  
13 drive in it that's resident at the business that has  
14 music on it that plays back music from this hard  
15 drive.

16 Q Now, I'd like to go through each of these  
17 delivery models in turn, but just to start things out  
18 for the panel, could you please explain to us how  
19 music is programmed for delivery to business  
20 establishments?

21 A Well, first of all, CDs are obtained by  
22 our music programming specialists that are principally

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1 located in Los Angeles. These CDs are previewed by  
2 each one of the music programmers and each track is  
3 categorized as to what style it belongs in, energy,  
4 tempo, the mood it sets.

5 Q And what is the purpose of these  
6 programming perimeters that you've identified for us?

7 A They're used to determine how often the  
8 particular tracks should play, what style it should  
9 play and what order it should come in the play list;  
10 things like that.

11 Q Now, during the programming phase, are  
12 there any copies made of the CDs?

13 A No.

14 Q Now, what happens after the programming  
15 phase with the music that's been listened to by the  
16 programmers?

17 A It's -- the CDs are physically sent to our  
18 worldwide origination center in Denver, Colorado where  
19 the first thing that happens is the content on the CD  
20 that's been selected by the programmer is QCed. And  
21 by that I mean we look for any pops or clicks, or  
22 errors in the digital stream. If there are any, we

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1 fix them.

2 We might also adjust the volume level that  
3 the recording is made at so that every song we play  
4 back in our programming plays back at the same volume  
5 level.

6 We also might look at the ending of the  
7 song. If it has a long, long fadeout, we might trim  
8 that fadeout so that it butts up seamlessly next to  
9 the next song that would be played.

10 Then we -- we take that QCed content and  
11 compress it into several different compression formats  
12 that we use, and store it on a master file server  
13 that's the main depository for all the music that we  
14 program.

15 Q Now, does the programming phase that  
16 you've described for us vary from distribution model  
17 to distribution model?

18 A No, it's essentially the same for each  
19 model.

20 Q Okay. Now you mentioned the file server  
21 that's at the worldwide operations center. Could you  
22 describe for us the operation of that file server?

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1 And perhaps lets start with the DBS cable model of  
2 distribution.

3 A Okay. Can I have the first slide, please?

4 MS. AISTARS: For the panel's reference,  
5 we'll be using the exhibit that are attached to Mr.  
6 Talley's testimony as Exhibits A, B and C, and we've  
7 made copies for your convenience.

8 CHAIRMAN VAN LOON: Thank you.

9 And I want to compliment both you and Ms.  
10 Aistars. You've done a excellent job so far of  
11 keeping your voice up, unlike some other witnesses.  
12 We need for the recording purposes and to make sure  
13 everybody in the room hears. Appreciate it very much.

14 THE WITNESS: Okay.

15 BY MS. AISTARS:

16 Q Okay. This is a little hard to read. But  
17 before I get into the minutia of this chart, just let  
18 me describe some more about the way the file server  
19 operates, which is housed at the Denver origination  
20 center and where all of our content originates from.

21 Basically there's a large depository of  
22 songs in the compressed and encrypted format in this

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1 file server. Right now we have over a million songs  
2 in that file server.

3 Each music format that we program, whether  
4 it be jazz, rock, classical has a separate computer  
5 that draws content from this file server. Every day  
6 we load up the client computers that have the jazz or  
7 the rock format designations with new play lists. And  
8 the play lists, as they proceed from song-to-song, the  
9 client computers draw content from the main file  
10 server and play out those songs on an individual  
11 basis.

12 At anyone time the client computers might  
13 hold up to 8 hours of music, and that music's placed  
14 on a first in/first out basis.

15 Q And how frequently is it replaced?

16 A Approximately 8 hours.

17 And then in our broadcast model, which  
18 this slide illustrates, the signal is transmitted, the  
19 multiplex music which in this case is the feed to our  
20 main satellite, Telstar 4, consists of 120 channels of  
21 music. The encrypted content is transmitted to that  
22 satellite and then it comes down to various places all

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1 over the U.S.

2 The primary distribution path of this  
3 encrypted music is to businesses with small one meter  
4 satellite dishes and a satellite receiver. And they  
5 can receive this stream music in their stores or  
6 restaurant.

7 We also distribute it to cable TV  
8 operators who re-inturn transmit it over their cable  
9 TV networks to their subscribers. And it's received  
10 on digital set top boxes where it's decrypted and  
11 decompressed and turned back into analog music that  
12 they can play through their speakers.

13 We also have a subcontractor called  
14 Microspace located in Raleigh, North Carolina that  
15 retransmits this music. Receives it from Telstar 4  
16 and then retransmits it to another satellite, and it  
17 in turn goes to other subscribers that have satellite  
18 dishes pointed at a satellite called Galaxy 3R.

19 We are in Denver co-resident with the AT&T  
20 technical operations that serves their cable networks.  
21 And we give this same music to AT&T, and they in turn  
22 redistribute to their cable TV subscribers throughout

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1 the U.S.

2 Q Mr. Talley, are you familiar with the  
3 terms "caching" and "buffering?"

4 A Yes.

5 Q And could you tell us how you understand  
6 these terms?

7 A Well, neither of these terms have precise  
8 engineering definitions. It's not like if you asked  
9 me to define what a watt is or a volt, I could give  
10 you precise scientific definition that every engineer  
11 would understand and agree with. But I think for the  
12 purposes of illustration, I could give you some  
13 examples of what these two terms are.

14 For example, if I had a hose in my garden  
15 with water coming out of it, and I had a bucket. And  
16 I would fill that bucket up with water from that hose  
17 then I'd instantly empty it, fill it up, fill it up  
18 again; keep doing that repetitively. That's what's  
19 commonly known as buffering.

20 If I filled that bucket up once, put it  
21 down over here, came back to it in an hour, maybe  
22 emptied it, fill it up again I could call that

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1        caching.

2                    To give you another example, which is more  
3        relevant to these proceedings, every CD player has a  
4        circuit in it called a DDA converter. And part of  
5        that circuit is a thing called a buffer. And 44,000  
6        times a second when that CD is playing, 32 bits of  
7        data from the CD are taken off the CD and put into  
8        that buffer, and then it's converted to analog left  
9        and right signals.

10                   So, for a typical CD for a 4 minute song,  
11        you would make over 10 million buffer copies in the  
12        process of playing that CD.

13                   Q        Your explanation --

14                   CHAIRMAN VAN LOON: I'm sorry. Could you  
15        just say that again? 10 million buffer copies?

16                   THE WITNESS: For a 4 minute song --

17                   CHAIRMAN VAN LOON: Yes.

18                   THE WITNESS: 10 million buffer copies are  
19        made.

20                   CHAIRMAN VAN LOON: That's what I thought  
21        you said.

22                   BY MS. AISTARS:

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1           Q       Now, when we were discussing h ow the  
2 music is transmitted from the Denver facility to the  
3 ultimate end user, I believe you made reference to a  
4 client server in the Denver facility that stored the  
5 content for a period of 8 hours, I believe you said.

6           A       Yes.

7           Q       With respect to this DBS model  
8 transmission and the cable model of transmission,  
9 could you tell us whether there are any other cache  
10 copies of the content made to facilitate the  
11 transmission?

12          A       In this process there's no caching that  
13 goes on. There's many buffer copies made.

14          Q       And could you explain where the buffer  
15 copies might be made?

16          A       Well, in the process of encrypting the  
17 content, compressing it, transmitting it, receiving  
18 it, decompressing it, decrypting it there's several  
19 buffer copies made. Playing it back, converting it  
20 into analog there's several stages of this process  
21 where buffer copies are made.

22          Q       Now, Mr. Talley, if we could move on to

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1 some of the other models of transmission that you  
2 mentioned for us. I believe you said that DMX also  
3 delivers content to business establishments using a  
4 hard disk based device called Axis. Could you  
5 describe that device for the panel?

6 A Yes. On the next slide we show the  
7 transmission path for the Axis product. What Axis is  
8 is essentially a small unit the size of a set top box  
9 with a large hard drive in it. When a customer orders  
10 our music from us, if they want classical or jazz, we  
11 send them a unit that has a hard drive preprogrammed  
12 with a large amount of content that's consistent with  
13 the style they ordered. A typical unit can hold up to  
14 700 hours of music.

15 And then through a private network that's  
16 connected between the Axis unit in the business and  
17 our origination center in Denver, on a daily basis we  
18 send that unit new music and new play lists for it to  
19 play.

20 The unit, for all intents and purposes,  
21 from the customer's standpoint works exactly like the  
22 satellite receiver. They select a channel and the

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1 music streams out. And it only plays music that we  
2 tell it to play on command from the play list we send  
3 it.

4 Q And is it possible for the customer in the  
5 business establishment to get access to the content  
6 stored in the Axis device?

7 A The customer has no control over the  
8 individual songs. There's no user interface that  
9 allows the user to identify a song and dig into the  
10 directory that has those songs on there. It only play  
11 back what we command it to play. And the user  
12 experience, as I mentioned, is exactly the same as if  
13 they had the satellite receiver.

14 Q Could you describe for the panel what, if  
15 any, security measures are employed in the Axis device  
16 to protect the content that's stored there or to  
17 protect that content that's been transmitted to the  
18 device?

19 A Well, first of all, everything that's sent  
20 to it is sent in an encrypted format, proprietary  
21 encryption format that we license from IBM. It's sent  
22 in this encrypted format from our origination center

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1 in Denver. It's stored on the hard drive in an  
2 encrypted format. And that only when that song is  
3 played back is it decrypted and turned back into an  
4 analog song that would play out through the PA system  
5 in the store.

6 We also maintain ownership, DMX maintains  
7 ownership of all the equipment. So the store or  
8 business never has title to the product or the content  
9 on it.

10 There's also a timeout device built into  
11 the player so that if -- if it's disconnected from our  
12 network or it's removed from the store, or somebody  
13 steals the unit, after a specified period of time the  
14 unit deactivates and it won't play music.

15 The content is encoded at a lower data  
16 rate than normally would be attractive to consumers.  
17 Typically for people with MP3 players and things like  
18 that, they record their music at 128 kilobits and it's  
19 recorded in stereo, and it's a popular consumer format.  
20 All this music is recorded at half the data rate and  
21 it's a slightly lower quality than would be attractive  
22 to consumers. And it's also recorded in mono.

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1           Q       Now, Mr. Talley, the final model of  
2 distribution that I believe you mentioned was the CD  
3 based model. Could you describe that model for the  
4 panel, please?

5           A       Yes. This slide shows that model where  
6 the content is encoded onto specially coded CDs at our  
7 on premise operations in Seattle.

8                   From Denver where we have our master file  
9 server over a private network, the content is  
10 distributed to Seattle and then specially coded CDs  
11 are produced and sent to each customer on a monthly  
12 basis.

13          Q       And you mentioned these are specially  
14 encoded CDs. Could you describe if there are any  
15 other security measures that are taken with this CD  
16 model of distribution?

17          A       Again, the playback device and the CDs are  
18 retained in ownership by DMX. There's also a built in  
19 timer that won't played CDs after a certain specified  
20 period of time.

21                   The format used to compress an encrypt the  
22 CDs is incompatible with consumer CD players. So if

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1 anybody steals the CD and tries to play it on their  
2 own player, it wouldn't play.

3 CHAIRMAN VAN LOON: Are those, the  
4 transmissions going from Seattle out to the individual  
5 businesses, is that again like in the mail?

6 THE WITNESS: Yes, that's mail.

7 CHAIRMAN VAN LOON: Yes.

8 BY MS. AISTARS:

9 Q Now, you've described for us the security  
10 measures that are incorporated in each of the various  
11 distribution models. Are there any measures that you  
12 take at your own facilities to protect the content?

13 A Well, everything in our operations that is  
14 used to store or distribute the music is on its own  
15 private network, which is independent of the other  
16 networks we use for email and connections to the  
17 Internet and other business purposes.

18 It's also -- everything's also encrypted  
19 using a triple DES algorithm, which is a standard high  
20 security algorithm that's used by many financial  
21 institutions for the transmission of secure data. And  
22 it's not at present exportable to other countries.

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1 Q Has your network ever been hacked?

2 A Since I've been at DMX, there's never been  
3 a known instance of hacking of the music network.

4 Q And, Mr. Talley, what if any programming  
5 measures are taken to prevent the copying of sound  
6 recordings used in DMX's services to business  
7 establishments?

8 A Well, first of all, all the programming  
9 software that puts together the play list has checks  
10 and balances in it that complies with the sound  
11 recording performance compliment.

12 Second, a very high percentage of the  
13 music is programmed so that it is cross-faded from  
14 song-to-song. So there's not distinct beginnings or  
15 endings of each song, and this also discourages people  
16 from trying to tape or hack the music.

17 Q Now, I believe that you said that another  
18 purpose of your testimony here today was to talk about  
19 how your technology promotes CD sales. What does DMX  
20 do, if anything, on a technology front to promote the  
21 sales of CDs?

22 A Several things. First of all, the

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1 equipment, the satellite receiver and the Axis unit  
2 itself have readouts on them, liquid crystal displays  
3 that every time a song plays it displays the artist,  
4 the album and the title of the song.

5 Also through our cable TV distribution  
6 whenever a song plays on screen on TV is that same  
7 information; the artist, album and the title.

8 In our next generation systems that we're  
9 developing now for interactive cable set tops, the  
10 album art will also be on screen, and also ways for  
11 the subscriber to point and click and order the album  
12 on line via the cable return path.

13 We also have a website that shows for any  
14 channel music that we broadcast the last 15 songs that  
15 are played and the time that they're played. And so  
16 a subscriber could go to our website and get  
17 information on that song.

18 And we also have a large number of  
19 customer service people located in Los Angeles and  
20 Seattle that routinely take calls from subscribers,  
21 and they're trained to answer questions about the  
22 music and help people get information on how to buy

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1 it.

2 Q And why do you employ all of these  
3 technologies to provide this information?

4 A Well, it's part of the appeal of the  
5 service. It's a benefit that we sell. And it's  
6 valued highly by our subscribers.

7 Q Now, the next area that I'd like to turn  
8 to is the reasons for the use of cache and buffering  
9 copies in your processes. Could you tell us what, if  
10 any, effect it would have on your business if you were  
11 required to account for the number of buffer and cache  
12 copies that you make in any given transmission?

13 A Well, in my opinion, it's really not  
14 practical. There are so many events that effect the  
15 number of copies that get made. It would be extremely  
16 difficult or impossible to keep track of all these  
17 things. Every time a CD is played buffer copies are  
18 produced. Equipment fails, a new piece of equipment  
19 has to go on line. We may have to take backup copies  
20 and replicate them. It's just not practical in the  
21 process of producing the music and transmitting it to  
22 keep track of all these ephemeral copies.

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1           Q     And would it be practical to count the  
2     buffer or cache copies made in any one particular  
3     transaction?

4           A     No, because there are so many steps that  
5     we go through.     There's encryption, decryption,  
6     encoding, decoding, decompressing, conversion of the  
7     signal from analog -- from digital to analog. There's  
8     just too many processes to keep track of.

9                     There's also quite a bit of hardware and  
10    software that we use that we don't control, we don't  
11    design it. We buy it off the shelf. And there's  
12    ephemeral copies being made in this software and  
13    hardware. And we would have no way to determine how  
14    many of these copies are made in this hardware and  
15    software.

16          Q     And when you were providing some examples  
17    of what you mean by cache and buffer copies for the  
18    panel, you were fairly specific in identifying, for  
19    instance, in the CD playback an example of how many  
20    ephemeral copies might be made. Is this something  
21    that's standard or is this something that might vary  
22    from device-to-device or technology-to-technology?

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1           A       It can vary from device-to-device. It can  
2 vary from how the equipment is used by the operators.

3                   We may have an editor that may have to  
4 edit a song several times before it's right for air  
5 play.

6                   I couldn't tell you how many times a  
7 particular song would be played back on a CD player or  
8 not played back.

9           Q       And why does DMX employ technologies that  
10 require the making of buffer and cache copies?

11           A       We really have no option. We're dealing  
12 with digital media today. This is incidental to the  
13 process of producing quality content and delivering it  
14 to our customers.

15           Q       And what if any benefits does the use of  
16 this technology which results in the making of buffer  
17 or cache copies afford DMX?

18           A       Well, there's some value to us in terms of  
19 efficiency. But there's also value to the copyright  
20 owner from the standpoint that we can encrypt the  
21 content to a much higher degree and protect it to a  
22 much higher degree than we could if it was in an

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1 analog form. And also, we can guarantee that the  
2 quality of the content that we deliver is much higher  
3 than we normally would.

4 Q Thank you, Mr. Talley.

5 MS. AISTARS: That's all I have.

6 CHAIRMAN VAN LOON: Mr. Garrett?

7 CROSS EXAMINATION

8 BY MR. GARRETT:

9 Q Mr. Talley, I'm Bob Garrett. I represent  
10 the Recording Industry Association of America.

11 Good morning.

12 A Good morning.

13 Q In the last series of questions you talked  
14 about value of the -- of buffer and cache copies in  
15 terms of the efficiencies that it offers you. What  
16 did you mean by that?

17 A Well, in terms of being able to process  
18 the content and edit it, and QC it, the digital  
19 technologies that we have today versus what we had  
20 several years ago with analog allows us to get higher  
21 throughput, get the work done faster.

22 Q Okay. Any other kinds of efficiencies?

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1           A       In terms of distribution we can distribute  
2 the content without using as much band width as we  
3 used to use for analog.

4           Q       And that brings down your band width cost?

5           A       There's some improvement there.

6           Q       You mentioned at the outset of your  
7 testimony the merger of AEI and DMX. Do you recall  
8 that?

9           A       Yes.

10          Q       I take it you're the chief technical  
11 officer of the merged company, is that correct?

12          A       Yes.

13          Q       Are the two companies that were merged,  
14 AEI and DMX, run separately or are their operations  
15 consolidated?

16          A       Well, we're starting to consolidate the  
17 efforts. The merger was just completed in May, so  
18 we're still going through a process of integration.

19          Q       Yes, but you do have responsibility for  
20 both sets of operations, correct?

21          A       Today I do.

22          Q       Okay. You referred earlier to the fact

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1 that you had 120,000 business customers, correct?

2 A Yes.

3 Q Is that 120,000 business customers for the  
4 merged operation?

5 A Yes.

6 Q Okay. Now, could you tell me of those  
7 120,000 customers how many operate under your  
8 broadcast model?

9 A I couldn't be specific. I would say the  
10 majority of them do.

11 Q And how about the Axis technology?

12 A It's new technology, a very small number.

13 Q Something around 5 percent?

14 A Even less than that.

15 Q Under one percent?

16 A Today there's probably a couple of  
17 thousand users.

18 Q And on the on premises model would be the  
19 remainder, so something less than a majority?

20 A Yes.

21 Q And your on premises model, yesterday Mr.  
22 Knittel testified and talked about certain on premises

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1 models that AEI had with Pro Pac and Pro CD. Are you  
2 familiar with those?

3 A Uh-huh.

4 Q Say yes.

5 A Yes.

6 Q And the Pro Pac and Pro CD is what you're  
7 describing here in your on premises model? Let me  
8 rephrase that.

9 When you described the on premises model  
10 were you including within that what has been referred  
11 to as Pro Pac and Pro CD?

12 A What I was describing in this diagram was  
13 what DMX has been doing. This doesn't cover what AEI  
14 has been doing.

15 Q All right. Let's focus then for a moment  
16 on the on premises model. Is there any difference in  
17 the model that you described on the one hand and the  
18 Pro Pac and the Pro CD models on the other hand?

19 A No, they're technically -- they're  
20 similar.

21 Q Okay. And are you familiar with the Pro  
22 Fusion method of providing -- of servicing your

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1 customers, correct?

2 A Yes.

3 Q And when you described the Axis technology  
4 here, is there any difference between the Axis  
5 technology on the one hand and the Pro Fusion  
6 technology on the other hand?

7 A The only difference is that the Pro Fusion  
8 technology presently uses CD ROMs to update it on a  
9 monthly basis. The Axis equipment connects  
10 electronically to the server in Denver and is updated  
11 by this electronic path.

12 Q I see. And when Pro Fusion uses CD ROMs,  
13 I take it that CD ROMs are mailed?

14 A Yes.

15 Q All right. And lastly, on the broadcast  
16 model, is there any difference between the DMX  
17 broadcast on the one hand and the AEI broadcast model  
18 on the other hand?

19 A The only difference is the number of  
20 channels that are transmitted. Also the DMX broadcast  
21 model has a lot more music transmitted than the AEI  
22 model. And the AEI equipment also broadcasts what we

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1 call in store messaging; announcements that the store  
2 may want to insert between the music. The DMX  
3 equipment doesn't do that.

4 Q I take it for all of the models that  
5 you've described here, that initially the CDs are  
6 placed into a digital depository that is located in  
7 Denver, is that right?

8 A Yes.

9 Q Let me go back to your broadcast model  
10 again. And if I could just ask you to look at the  
11 chart that you prepared for that broadcast model. Do  
12 you have that before you?

13 A Yes.

14 Q Just incidentally, whose chart do you  
15 think is better, yours or mine?

16 A I haven't seen yours.

17 Q That's okay. They put this in just to  
18 embarrass me, you know that.

19 All right. Well, just focusing on the  
20 broadcast -- oh, one other thing, too. You talked in  
21 terms of buffer copies and cache copies, do you recall  
22 that?

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1 A Yes.

2 Q At one point in your oral testimony you  
3 also referred to ephemeral copies, do you recall that?

4 A Yes.

5 Q Is your reference to ephemeral copies  
6 meant to meant to include buffer and cache copies?

7 A Yes.

8 Q Does it include anything other than buffer  
9 and cache copies?

10 A No.

11 Q Okay. So if I use the term ephemeral  
12 copies, we could use that as a term synonymous with  
13 both buffer and cache copies, correct?

14 A Yes.

15 Q Okay. All right. Turning to your U.S.  
16 broadcast model here, can you tell me at what stages  
17 in the process here ephemeral copies are made?

18 A Every stage from the transmission to the  
19 reception. There are many, many, many places where  
20 this happens, where ephemeral copies are made.

21 Q Okay. Well, let's just if we could go  
22 through the whole process.

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1 A Okay.

2 Q And identify each of the stages here. I  
3 gather in the first step is that the physical CDs are  
4 copied into the digital repository, correct?

5 A Yes.

6 Q Okay. Do you consider those copies to be  
7 ephemeral copies?

8 A Yes.

9 Q And those copies are periodically purged  
10 from the digital repository, is that right?

11 A Yes.

12 Q Are any copies maintained there on a  
13 permanent basis?

14 A They could be. The purge -- how often we  
15 purge it is a variable.

16 Q What does it vary at?

17 A How often we play the music, whether it's  
18 needed on a regular basis or it's not needed.

19 Q There is no set policy that everything  
20 within the digital repository must be purged within a  
21 specified period of time?

22 A No.

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1           Q       Okay. Now, when copies are placed in the  
2 digital repository, is there more than one copy made  
3 of each CD?

4           A       No.

5           Q       And you would consider the copying of a  
6 single CD into that digital repository to be either a  
7 buffered copy or a cache copy?

8           A       Well, yes. Just let me clarify my last  
9 answer.

10                   In the process of storing a copy, an  
11 ephemeral copy into the master server, there's several  
12 processes that we go through first to get it there.  
13 There's QCing, there's a slight amount of editing that  
14 might be done, there's volume leveling, there's  
15 encryption, compression. Throughout all these  
16 processes before it even gets on the server, there's  
17 ephemeral copies made.

18           Q       And those copies are made at your  
19 operation center there in Denver?

20           A       Yes.

21           Q       Once all of that process is gone through  
22 and you're actually putting the copy into the digital

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1 repository, is the copy that goes into the digital  
2 repository considered to be either a cache copy or a  
3 buffer copy?

4 A Yes.

5 Q Which one is it or is it both?

6 A I would call it a cached copy.

7 Q And why would you call it a cached copy?

8 A Because it's retained for unspecified  
9 period of time.

10 Q All right. Sticking with your broadcast  
11 model, we've got the CD in the digital repository.  
12 Where does it go next?

13 A Well, we have what we call client playback  
14 computers that on command from the individual play  
15 lists that are loaded into these client computers,  
16 they draw music from the master depository and decode  
17 it and play it out of those client computers.

18 Q Physically where are these client playback  
19 computers located?

20 A They're in the same room as the master  
21 file server in Denver.

22 Q And how many -- in Denver, right?

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1 A Yes.

2 Q And how many such computers are there?

3 A Approximately 120.

4 Q Is it like one computer for each channel  
5 of programming that goes up to the satellite, is that  
6 right?

7 A Yes.

8 Q And so you'd have one computer that might  
9 be devoted to a jazz channel and another one that  
10 might be devoted to a classical channel, is that  
11 right?

12 A Yes.

13 Q Now do you consider the copies that reside  
14 in that playback computer to be either cache or buffer  
15 copies?

16 A Well, in normal operation everything in  
17 that computer is replaced on a first in/first out  
18 basis on a regular time interval. So under normal  
19 circumstances I would call that caching.

20 If there's a failure of the main server or  
21 if the main server goes down, what we do is we start  
22 to loop the music from the client computer. And in

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1 that mode then it operates like a cache. It keeps  
2 playing back the last 8 hours of music until we fix  
3 the problem with the main server.

4 Q Okay. What's the next step then after the  
5 -- you've got the different tracks in the client  
6 playback computer. Are they then transmitted from  
7 that computer up to satellite?

8 A Right, but before that happens those  
9 tracks are encrypted, they're compressed again into  
10 the compression format used on the satellite system,  
11 which may be different than the -- and in many cases  
12 is different than the compression format we use to  
13 store it on the server.

14 They're also multiplexed together so that  
15 all 120 channels is transmitted in a blanket format.  
16 And in all those processes there are ephemeral copies  
17 made.

18 Q Okay. After ephemeral copies are made,  
19 then they are actually transmitted up to the  
20 satellite, correct?

21 A Yes.

22 Q And that's the Telstar 4 satellite that

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1 you described?

2 A Yes.

3 Q And then your customers -- one way your  
4 customers can receive the programming is that they  
5 take their earth station or their dish and simply take  
6 it down from the Telstar 4 satellite, correct?

7 A Yes.

8 Q Okay. Now, between the time that it's up  
9 there on satellite and it goes down to that receiving  
10 dish are any ephemeral copies made?

11 A No.

12 Q Okay. All right. I gather another way  
13 your customers can receive it, is rather than directly  
14 from the Telstar 4 satellite, they would get it from  
15 Microspace, is that right?

16 A Yes.

17 Q And Microspace would take it down from the  
18 Telstar 4 satellite and put it back up on the Galaxy  
19 3R satellite, correct?

20 A Yes.

21 Q And in the process of taking it down from  
22 the -- strike that.

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1                   In the process of Microspace taking the  
2 programming down from the Telstar 4 satellite, are any  
3 copies, ephemeral copies made?

4                   A       When Microspace receives the signal, they  
5 receive it demultiplexed, decrypted, turn it back into  
6 an analog signal and then retransmit it. So that  
7 whole process of receiving it creates ephemeral  
8 copies?

9                   Q       Okay. And then once they create those  
10 ephemeral copies, they retransmit them back up to the  
11 Galaxy 3R satellite, correct?

12                  A       Yes.

13                  Q       Are there any ephemeral copies created in  
14 the course of that transmission?

15                  A       Not to my knowledge.

16                  Q       All right. And then again your customers  
17 could take it down from the Galaxy 3R satellite,  
18 correct?

19                  A       Yes.

20                  Q       And in the process of taking it down from  
21 that Galaxy 3R satellite are any copies, ephemeral  
22 copies made?

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1           A       The same thing would happen again. In the  
2 reception of the signal and decoding of the signal  
3 there would be ephemeral copies made.

4           Q       Okay. And they take the -- regardless of  
5 whether your customer got it from the Telstar 4  
6 satellite or the Galaxy 3R satellite, after those  
7 ephemeral copies were made, what would happen to the  
8 programming next?

9           A       It would be played back through the  
10 speakers in the store or business.

11          Q       Okay. Any ephemeral copies that would be  
12 created in that process?

13          A       No.

14          Q       Now, one other method of distribution you  
15 discussed earlier involves cable. Do you recall that?

16          A       Yes.

17          Q       And as I look on your chart here, it  
18 appears that you transmit your programming to the HITS  
19 affiliate, correct?

20          A       Yes.

21          Q       Exactly what is the HITS affiliate?

22          A       Well, HITS is an acronym that stands for

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1 Head In the Sky, and it's a technical broadcast  
2 facility that AT&T has located at the same facility  
3 that our studios are at in Denver. And what they do is  
4 receive content from many different sources; video and  
5 audio providers. And then they reencrypt it, they  
6 remultiplex it, they recompress it into the format  
7 that's compatible with all the AT&T cable system and  
8 set top boxes. And then they retransmit it to their  
9 subscribers in that format.

10 Q All right. This is the digital service  
11 that the cable operators offer, correct?

12 A If you have AT&T digital cable, you have  
13 this HITS service.

14 Q Okay. Now your transmission from Denver  
15 to HITS is done via microwave?

16 A No. Actually, it's done by a wire.

17 Q Fiber optics or cable?

18 A It's coax cable.

19 Q Coax cable. Okay.

20 In the process of taking the programming  
21 there from your operations in Denver and getting it  
22 over to HITS, are any ephemeral copies made?

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1 A No.

2 Q Okay. When HITS receives that programming  
3 and transmits it off to various cable operators, are  
4 any ephemeral copies made there?

5 A Yes.

6 Q And are these cache copies or buffer  
7 copies, or both?

8 A I would call them buffer copies.

9 Q Okay. Once the cable operators receive  
10 them, they will then further transmit them to your  
11 business customers, correct?

12 A Yes.

13 Q Are there any ephemeral copies made in  
14 that process there?

15 A Yes.

16 Q And, again, are these cache or buffer  
17 copies?

18 A I would call them buffer copies.

19 Q Okay. Why would you call them buffer  
20 copies?

21 A Because there are several steps where the  
22 signal is received, decoded, decrypted, converted from

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1 digital to analog.

2 Q Okay. I guess as you said in your  
3 broadcast model there are a lot of different ephemeral  
4 copies that are made, correct?

5 A Yes.

6 Q And if you can't make those ephemeral  
7 copies, you can't use this broadcast model, can you?

8 A That's correct.

9 Q Okay. Just turn for a second to the on  
10 premises model. Are there ephemeral copies that are  
11 created in the course of providing your services via  
12 the on premises model?

13 A Yes.

14 Q All right. Can you tell us again where  
15 would the first set of ephemeral copies be made?

16 A Are you referring to the Axis slide or --

17 Q No, I'm referring to the on premise model.

18 A On premises. Okay.

19 Q Which would also be like Pro Pac or Pro  
20 CD. The third slide.

21 MS. AISTARS: Actually, I think he  
22 testified that this represents DMX's activities and

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1 not Pro Pac and Pro CD.

2 MR. GARRETT: Right. That reminds me.

3 BY MR. GARRETT:

4 Q Let's go back to the broadcast model that  
5 we just discussed here. You talked about the  
6 different steps or the different stages at which  
7 ephemeral copies would be made. Would there be any  
8 difference if we focused not just on the DMX broadcast  
9 model, but on the AEI broadcast model?

10 A There are some AEI broadcast operations  
11 that are done with analog technology. DMX uses all  
12 digital.

13 Q Where does AEI use analog?

14 MS. AISTARS: If you know.

15 THE WITNESS: There are some analog  
16 satellite transmissions made through the specific AEI  
17 satellite that are used. And there's some reception  
18 with analog equipment.

19 BY MR. GARRETT:

20 Q Which satellite does AEI use. It's not  
21 Telstar 4, I take it?

22 A AEI uses several satellites, but the main

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1 one is Galaxy 3R.

2 Q I take it for the AEI broadcast model to  
3 operate, it's necessary to make ephemeral copies at  
4 various stages, correct?

5 A Yes.

6 Q And without making those ephemeral copies  
7 they would not be able to operate using their  
8 broadcast model, correct?

9 A Correct.

10 Q Now, does AEI in its broadcast model ever  
11 make digital transmissions?

12 A Yes.

13 Q And now let's go over to the on premises  
14 model, which was your third chart.

15 And just focusing on the DMX on premises  
16 model described in your chart here, can you tell me at  
17 what stages the ephemeral copies are made?

18 A Well, starting with the origination  
19 operations in Denver where the file server has the  
20 music stored, and I've previously described how that  
21 music gets on that file server and the ephemeral  
22 copies that are made in the process of doing that.

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1                   Then the output of that server delivers  
2 music to Seattle. There are ephemeral copies made in  
3 that process. And in Seattle that music is burned  
4 onto CD ROMS. And there ephemeral copies made in that  
5 process.

6                   And when it's transmitted or actually via  
7 the mail to the subscriber and they play the music  
8 back, there are several ephemeral copies made in the  
9 process of playing it back.

10                  CHAIRMAN VAN LOON: Can I just clarify on  
11 that. You just said and then are several made in the  
12 subscriber's playback.

13                  THE WITNESS: Yes.

14                  CHAIRMAN VAN LOON: A little earlier you  
15 talked about, I forget it was 10 million in a form in  
16 a song.

17                  THE WITNESS: Right.

18                  CHAIRMAN VAN LOON: When you said several  
19 now, do you really mean a lot like millions or are  
20 there significantly fewer of ephemeral copies in the  
21 subscriber playback?

22                  THE WITNESS: I mean millions.

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1 CHAIRMAN VAN LOON: I see.

2 BY MR. GARRETT:

3 Q I just want to make sure I understand.  
4 When I put a CD in my computer to play, am I making  
5 ephemeral copies?

6 A Yes.

7 Q Okay.

8 CHAIRMAN VAN LOON: Not if you don't play  
9 it.

10 MR. GARRETT: If you don't play it, right.  
11 Turn it on.

12 THE WITNESS: If you put a CD into a  
13 normal CD player, you're making ephemeral copies every  
14 time it takes 32 bits of data from that CD and  
15 converts it from an digital signal to an analog signal  
16 and it's buffered for a short period of time -- it's  
17 a short period of time. It's maybe 23 microseconds.  
18 But during that time you've created a buffer copy of  
19 a portion of the content.

20 CHAIRMAN VAN LOON: And each time -- and  
21 every 4 minute song --

22 THE WITNESS: Every 4 minute song --

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1 CHAIRMAN VAN LOON: -- whether it's on  
2 your CD player or --

3 THE WITNESS: -- represents about 10  
4 million ephemerals.

5 ARBITRATOR VON KANN: Is this true, by the  
6 way, ephemerals or ephemeral copies, is this a  
7 lawyer's term or an engineer's term?

8 THE WITNESS: It's not my term. It's not  
9 an engineering term.

10 ARBITRATOR VON KANN: Okay. So you're  
11 familiar with it in the context of the copyright law  
12 and the lawyers. If we had an engineer convention,  
13 they wouldn't find the need to use the word ephemeral  
14 in talking about how their services work? They'd talk  
15 about buffer copies and cache copies, but they  
16 probably wouldn't talk about ephemerals?

17 THE WITNESS: It's not a highly used term  
18 in engineering parlors.

19 ARBITRATOR VON KANN: Okay.

20 BY MR. GARRETT:

21 Q Let's go back to your on premises model  
22 here. We've got the CDs in the file server there in

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1 Denver. And I gather from Denver they end up in  
2 Seattle, right?

3 A Yes.

4 Q Okay. Tell me exactly what happens  
5 between Denver and Seattle with all those different  
6 tracks that are in the file server?

7 A They're transmitted on a private network  
8 to Denver -- or to Seattle.

9 Q Transmitted digitally?

10 A Yes.

11 Q And you say in the course of that  
12 transmission there are buffered or cache copies that  
13 are made?

14 A Yes.

15 Q Is it buffered copies, cache copies or  
16 both?

17 A Buffer copies.

18 Q Okay. And why do you consider them to be  
19 buffer copies?

20 A Because they replenished on a regular  
21 basis. And usually it's only part of the content  
22 that's copied.

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1 Q Why is that?

2 A Just the way it works. The data is  
3 packetized and sent in packets, and it's decoded and  
4 replicated.

5 Now, when it gets to Seattle, the entire  
6 song is reassembled and put back together. So at that  
7 point I guess you could call that a cache copy.

8 CHAIRMAN VAN LOON: The private network  
9 that goes between Denver and Seattle --

10 THE WITNESS: Yes.

11 CHAIRMAN VAN LOON: That's a hard wire as  
12 opposed to being beamed, or how does that --

13 THE WITNESS: It's a virtual private  
14 network that uses the Internet to transmit part of the  
15 content on.

16 CHAIRMAN VAN LOON: I see.

17 BY MR. GARRETT:

18 Q And in Seattle the different tracks that  
19 you received here from Denver are copied onto a CD ROM  
20 you said?

21 A Yes, individual CD ROMs that are produced  
22 for each business subscribing to the service.

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1 Q And those CD ROMs are then mailed to the  
2 different subscribers, correct?

3 A Yes.

4 Q All right. Now, on your chart here you  
5 have different arrows from Seattle to the business  
6 establishments that are identified both as encrypted  
7 compressed physical disk and transmitted. Do you see  
8 that?

9 A Yes.

10 Q What does that refer to?

11 A The disks are sent via the U.S. Mail to  
12 the customer. And the disks are encrypted and  
13 compressed. The format of the content on the disk is  
14 encrypted and compressed.

15 Q Where is it encrypted or compressed?

16 A That happens in Seattle prior to the  
17 distribution and the production of the CD ROM.

18 Q All right. But all the distribution  
19 between Seattle and the business establishment is done  
20 really through the mail, correct?

21 A Yes.

22 Q Okay. Can you tell me -- let's just focus

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1 for a moment on the AEI on premises model, the Pro Pac  
2 or Pro CD. All right. Is there any difference  
3 between that model and the model you've described here  
4 in terms of where the ephemeral copies or the buffer  
5 or cache copies are made?

6 A It's essentially the same.

7 Q Okay. And let me ask you next about your  
8 Axis technology, the second chart that you have here.

9 Again, we start with the file server,  
10 correct?

11 A Yes.

12 Q And then from the file server there in  
13 Denver, what happens to the different tracks next?

14 A Well, there's a separate file server that  
15 we use to just house the music that needs to be  
16 transmitted or sent to the individual Axis users. And  
17 from the play lists for each customer we know what  
18 music is already resident on the hard drive and what's  
19 not on the hard drive. And everyday there's a  
20 schedule of songs and new play lists that need to be  
21 sent to various customers. Those songs and those play  
22 lists are loaded into this independent file server.

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1 And when the Axis unit at the business calls up for  
2 its daily download, it gets those particular songs and  
3 those particular play lists.

4 Q All right. So in the Axis technology  
5 we're dealing with two independent file servers, is  
6 that right?

7 A At our broadcast study, that's correct.

8 Q So the different tracks will start out in  
9 your main file server and then be transferred to this  
10 independent file server, correct?

11 A Yes.

12 Q All right. And in that process of  
13 transferring from the main file server to the  
14 independent file server are buffer or cache copies  
15 made?

16 A Yes.

17 Q Are they buffer copies or are they cache  
18 copies?

19 A They're cache copies and buffer copies.

20 Q They're both?

21 A Yes.

22 Q Okay. And then from the independent file

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1 server you will send different tracks to the -- is it  
2 the hard drives located at the different business  
3 establishments, customers, correct?

4 A Yes.

5 Q And you'll do that via the Internet or via  
6 telephone lines, correct?

7 A Yes.

8 Q Okay. And are there buffer or cache  
9 copies that are made in that process?

10 A Yes.

11 Q Are they buffer or are they cache?

12 A They're both.

13 Q Okay. Now, let me make certain I  
14 understand. In the process we were just describing  
15 here, you are updating the play list that reside on  
16 the hard drives at your business establishment  
17 customers, correct?

18 A Yes.

19 Q Am I correct that initially you take that  
20 hard drive unit is physically mailed or sent to the  
21 business establishment customer?

22 A We have installers that install it in the

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1 store.

2 Q Okay. But that hard drive that is  
3 ultimately installed in the store is originally loaded  
4 in Denver, correct?

5 A That's correct. Denver or Seattle.

6 Q Okay. And then what you do is you will  
7 update that on a periodic basis?

8 A Yes.

9 Q Okay. Are the different tracks that are  
10 loaded onto the Axis player there in Denver or  
11 Seattle, are those -- are ephemeral copies made in  
12 that process?

13 A Yes.

14 Q And, again, are they buffer or are they  
15 cache copies?

16 A They're cache copies.

17 Q Okay. Is there a policy, at least for the  
18 DMX operations, as to when the different cache or  
19 buffered copies must actually be purged from the  
20 system?

21 A It's variable. It depends on how often we  
22 play certain song. If it's a song that's been encoded

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1 and we don't use it any longer, it doesn't show up in  
2 any play lists, then it's purged.

3 Q Okay.

4 MR. GARRETT: I have no further questions.

5 Thank you, Mr. Talley.

6 MS. AISTARS: We have a few on redirect,  
7 but if I could take a minute.

8 CHAIRMAN VAN LOON: Please.

9 (Whereupon, at 12:16 p.m. off the record  
10 until 12:27 p.m.)

11 CHAIRMAN VAN LOON: Ms. Aistars?

12 MS. AISTARS: I just have one or two  
13 questions.

14 REDIRECT EXAMINATION

15 BY MS. AISTARS

16 Q Mr. Talley, do you recall that you used  
17 the term ephemeral per Mr. Garrett's suggestion  
18 earlier in your testimony?

19 A Yes.

20 Q And when you used that term as meaning  
21 buffer or cache copies, you didn't use it in the legal  
22 sense that's ascribed to that term under the Digital

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1 Millennium Copyright Act, did you?

2 A No. I'm not a lawyer and I've never read  
3 the Digital Millennium Copyright Act.

4 ARBITRATOR VON KANN: It's great stuff.

5 THE WITNESS: I was not using that in any  
6 legal context at all.

7 BY MS. AISTARS

8 Q Thank you.

9 MS. AISTARS: That's all.

10 CHAIRMAN VAN LOON: Either of you have any  
11 questions?

12 ARBITRATOR GULIN: Well, I guess I would  
13 ask, for example, on page 12 when you speak of number  
14 of ephemeral copies made in aid of licensed or exempt  
15 transmissions, when you were speaking of number of  
16 ephemeral copies made regarding exempt transmissions,  
17 there also you were not using it in a legal sense?  
18 The term ephemeral?

19 THE WITNESS: No.

20 ARBITRATOR GULIN: Okay. Thank you.

21 CHAIRMAN VAN LOON: I wanted to ask you,  
22 we had your colleague Barry Knittel here yesterday

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1 from the AEI side and more business person and not a  
2 technical person. And we asked him some of the same  
3 questions that you were asked today, and he gave good  
4 answers to the best of his ability, but he's not the  
5 chief technical officer and didn't know what you knew.

6 THE WITNESS: Yes.

7 CHAIRMAN VAN LOON: In a somewhat parallel  
8 vein, I know you're not as familiar with the business  
9 side as he is. I did want to inquire whether you are  
10 aware of part of his testimony was that the AEI/DMX  
11 proposal for this proceeding is that there be a  
12 minimum fee set and a suggested dollar amount for  
13 that. Are you aware of that aspect?

14 THE WITNESS: Not at all. I haven't had  
15 any discussions with Mr. Knittel about that.

16 CHAIRMAN VAN LOON: I see. Okay. Well  
17 then, my other question would be a waste of time.

18 Thank you very much for coming for these  
19 great diagrams. And you made it understandable to  
20 nonengineers. So thank you very much.

21 THE WITNESS: Thank you.

22 MR. STEINTHAL: I hope that wasn't

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1 intended as a slight to Mr. Garrett.

2 MR. GARRETT: I did take it that way, but  
3 that's okay.

4 CHAIRMAN VAN LOON: Never even crossed my  
5 mind.

6 We have at least two possibilities at this  
7 time.

8 One thing that we talked about yesterday  
9 is having a further conversation now about the  
10 rebuttal phase, giving you the 48 hours from our  
11 earlier conversation to have further conversations  
12 about that.

13 Also, we, the panel at least, have a  
14 question with regard to the applicability of 112(e) to  
15 these background music services. We would like to  
16 hear briefly from each side about that, briefly and  
17 informally. And if people were comfortable talking  
18 with us about that today, we'd be delighted. If you'd  
19 rather wait until next week or sometime, that would  
20 also be fine with us.

21 And we're also not sure whether the  
22 conversation about rebuttal is a five or 10 minute

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1 thing or a longer conversation.

2 So, we're prepared either to take our  
3 traditional lunch break at this time, then come back  
4 in an hour and talk about rebuttal phase and if you  
5 would like to talk about 112(e) today, take up both of  
6 those things. Or alternatively, and I guess  
7 especially if you want to put off the 112(e) -- and  
8 we're talking 10 or 15 minutes from each side. I  
9 mean, very sort of -- maybe less brief explanation and  
10 possibly some panel questions.

11 If we want to put that off until next  
12 week, we could possibly do the rebuttal conversation  
13 now and break before lunch.

14 MR. STEINTHAL: My own preference would be  
15 to do the rebuttal conversation now, adjourn since we  
16 don't have witnesses in the afternoon because the  
17 witnesses are tomorrow. And have the 112(e)  
18 discussion sometime next week.

19 I don't know if that's equally desirable  
20 to RIAA, but I know that we'd like to circle and talk  
21 a little bit with our clients on the 1121(e) issue too  
22 before we address it in the manner that you apparently

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1 want to address it.

2 And certainly I don't think that the  
3 rebuttal conversation is going to be that long. And  
4 if we can do it before lunch, it makes sense so we  
5 don't have to come back.

6 MR. GARRETT: Well, one other option is  
7 they could leave and I could talk to you about 112(e).

8 MR. BERZ: If we can both do it  
9 separately. I think we've tried that before and we  
10 haven't been able to work it out.

11 CHAIRMAN VAN LOON: Right.

12 MR. GARRETT: That's acceptable to us if  
13 they want to wait and talk about it next week, just  
14 tell us when you want to hear from us, and we'll be  
15 prepared to talk about it then.

16 CHAIRMAN VAN LOON: We were thinking that  
17 probably if it were next week, the logical time would  
18 be Wednesday after the witnesses and possibly still be  
19 able to get it all in the morning, depending on how  
20 long that is. We say that partly thinking that  
21 probably it'll be longer, more grueling days in the  
22 Marks' testimony. But, obviously, if we somehow ended

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1 up a half day early on Marks, we could do that as  
2 well.

3 MR. GARRETT: It may make some sense to  
4 allow us to review the transcript and prepare to talk  
5 to you in the context of having done that.

6 CHAIRMAN VAN LOON: Okay.

7 MR. BERZ: I think that'll work just fine.  
8 I'm just letting you know that I have court dates  
9 starting on Thursday and Friday of next week in the  
10 same case in Wilmington.

11 ARBITRATOR VON KANN: We won't be able to  
12 hear from you on Thursday.

13 CHAIRMAN VAN LOON: Okay. Wednesday and  
14 today. Okay. Wednesday will be the date.

15 Perhaps we could hear from you then on  
16 rebuttal on the further conversations you've had and  
17 where things stands.

18 (Whereupon, at 12:35 p.m. off the record  
19 until 12:37 p.m.)

20 MR. STEINTHAL: I've got a list of six  
21 things I thought we were going to talk about on this  
22 subject, and if no one else wants to go first, I'm

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1 happy to rattle down the list and see where we are.

2 CHAIRMAN VAN LOON: We have a list that  
3 says six? Six A&B.

4 MR. STEINTHAL: It may not be the same,  
5 but --

6 CHAIRMAN VAN LOON: This will be an  
7 interesting exercise. Please, sure.

8 MR. BERZ: You get 10 points for each --

9 MR. STEINTHAL: On just the sheer  
10 scheduling issue in terms of what dates we're doing.  
11 We're supposed to be before you. I have October 1 is  
12 the date by which -- or the day we're going to have  
13 sort of an interim conference with you before the  
14 hearing starts on scheduling, even before the witness  
15 statements get filed. And that keys to the fact that  
16 we're going to have some sort of designation of  
17 witnesses before then, which we'll talk about in a  
18 minute. But at a time, presumably to be set by Your  
19 Honors, we'll have some sort of conference, whether  
20 telephonic or in person, I don't know which is  
21 required.

22 But other than that, we're still on the

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1 witness statements due on the 4th.

2 The document production underlying the  
3 witness statements on the 5th.

4 On the 8th, which is the Monday after that  
5 Friday, each side informs the other of any problems  
6 they have with the document production or motions, or  
7 whatever they feel they may want to bring to the  
8 panel's attention.

9 On the 9th they exchange their positions  
10 with respect to that, and hopefully try to work  
11 whatever we can work out.

12 And then assuming there's anything left  
13 open, we would have a conference with you here in  
14 Washington in lieu of motions to resolve the open  
15 matters raised in the form of either motions or  
16 discovery issues.

17 Depending on how we do with numbers of  
18 witnesses and the like, we are holding the 12th and  
19 the 13th as potential hearing days; that Friday and  
20 Saturday. And then have the originally scheduled  
21 period starting on the 15th for hearings with the  
22 bracket around the Sunday in case the march goes

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1 through Sunday as the panel indicated we could do, if  
2 necessary. It's just there as a plug date to talk  
3 about if it's necessary.

4 ARBITRATOR GULIN: Let me just mention  
5 that the building's closed on Sundays, so we've got to  
6 have an alternate site.

7 MR. STEINTHAL: I think on a lot of that,  
8 the 12th and 13th and the Sunday, a lot of it depends  
9 on events between now and then in terms of witness  
10 statements, witness designations, etcetera. So, as  
11 Mr. Garrett said when we were doing this two days ago,  
12 you know, we'll be in a better position to inform the  
13 panel about time periods and the like once we see the  
14 witness designations.

15 So that's just my sort of list, that was  
16 the panel confirmed hearing dates or conference dates  
17 that I had as essentially pretty much taken without  
18 any kind of dispute from the conversation two days  
19 ago.

20 CHAIRMAN VAN LOON: Let me interject and  
21 go back to the October 4th date for witness statements  
22 to be in and just two reminders and clarifications.

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1                   One is that the panel has requested that  
2 we receive copies of the rebuttal statements on CDs in  
3 addition to the written paper format. And like to just  
4 remind you that.

5                   And second, we've been asked by the  
6 Copyright Office to remind you that that really means  
7 getting completed materials in before 5:00 on that day  
8 delivered fully assembled, normal course of business.  
9 And we want to honor that request.

10                  ARBITRATOR VON KANN: One question on the  
11 October 1 date conference re: scheduling. Was it your  
12 notation that by that point the parties having  
13 exchanged their witness list in some fashion, a call  
14 will be made in effect as to whether we need October  
15 12 and 13?

16                  MR. STEINTHAL: I think that I understood  
17 the concept to be that we would be in a better  
18 position by the 1st to make a call as to whether the  
19 12th and 13th would be advisable, yes.

20                  ARBITRATOR VON KANN: Okay.

21                  MR. GARRETT: I consider that the drop  
22 dead date we need the 12th and 13th, we would discuss

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1 that with you on that day. If we don't raise it on  
2 that day, we're not doing it on the 12th and 13th.

3 MR. STEINTHAL: I think that's a fair way  
4 to put it.

5 MR. GARRETT: But I also thought that we  
6 would use that occasion to talk about anything else  
7 that we thought might be helpful, appropriate,  
8 necessary to deal with the rebuttal phase.

9 ARBITRATOR VON KANN: The October 1 date  
10 was mentioned in our session on Tuesday, but I can't--  
11 I'm not sure how it came about nor is it really  
12 necessary, it seems to me, for it to push back that  
13 far.

14 You all talked about exchanging your  
15 witness list sometime between the 24th and Thursday  
16 the 27th.

17 CHAIRMAN VAN LOON: I was the one that put  
18 that on the 1st.

19 ARBITRATOR VON KANN: You were the one --  
20 okay. The 1st.

21 I don't know whether we could have that --  
22 all right, well there is a good reason. Is that time

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1 enough thought for you to line up witnesses on the  
2 12th and 13th if you had to?

3 MR. STEINTHAL: Well, that leads me to  
4 another issue, which is who goes first.

5 ARBITRATOR VON KANN: Okay.

6 MR. STEINTHAL: Which I neglected to chat  
7 with Mr. Garrett about.

8 ARBITRATOR VON KANN: Well, you got ten  
9 points. That's a match.

10 MR. STEINTHAL: We did have a sense from  
11 the initial discussion a long time ago that if the  
12 RIAA was going to go first in the direct case, then  
13 the broadcasters/webcasters would go first in the  
14 rebuttal phase. We've never formalized that in any  
15 kind of discussion either with the RIAA or with the  
16 panel. But certainly we're prepared to proceed on  
17 that basis.

18 ARBITRATOR VON KANN: You'd like to go  
19 first --

20 MR. STEINTHAL: I think -- yes, we've  
21 talked about it and believe it sort of gives -- you  
22 know, for various reasons we're -- we feel that we

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1 should be able to and are ready to go first.

2 CHAIRMAN VAN LOON: Did you say that had  
3 not been discussed --

4 MR. STEINTHAL: Well, I haven't talked to  
5 Mr. Garrett about, other than in a general sense a  
6 long time ago.

7 CHAIRMAN VAN LOON: I see.

8 MR. STEINTHAL: And we talked about this,  
9 who was going to first.

10 MR. GARRETT: We talked about it a long  
11 time ago. It's okay with us.

12 ARBITRATOR VON KANN: Okay. So then it  
13 would be, Mr. Steintal, you would have to line up  
14 witnesses by the 12th or 13th?

15 MR. STEINTHAL: Right. Right.

16 ARBITRATOR VON KANN: So the question is  
17 is October 1 time enough for you --

18 MR. STEINTHAL: We'll get our witnesses in  
19 here.

20 ARBITRATOR VON KANN: Okay.

21 CHAIRMAN VAN LOON: We're not dealing with  
22 August vacation days.

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1 MR. STEINTHAL: That's right, and we don't  
2 have Labor Day, we don't have August holidays.

3 ARBITRATOR VON KANN: You skipped over and  
4 said you were going to return to the question of  
5 witness statement lists?

6 MR. STEINTHAL: Yes. That's going out of  
7 order here because of the way things have gone, but  
8 certainly another item of my six was the issue of  
9 witness designation, both from a scheduling standpoint  
10 and how it's going to proceed.

11 We talked the other day about sometime  
12 between the 24th and the 27th. What we've proposed to  
13 the RIAA is that the designations be made on the 25th  
14 and that there would be the opportunity to one, and  
15 only one, on a basis that if there's a witness that is  
16 designated that it comes as a surprise to the other  
17 side, they should be able to add one person if it's  
18 necessary to rebut that.

19 With respect to the designations, we've --  
20 when we raised this with Mr. Garrett initially, we  
21 talked about at least for the expert having a short  
22 description of the subject matter of what they're

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1 going to address, especially if there's a new expert,  
2 for example. I think we would like to know what the  
3 subject matter is, and I don't think we had a  
4 disagreement about the fact that a two or three  
5 sentence description of the subject matter would be  
6 appropriate.

7 And then we would within two days from the  
8 25th, i.e. on the 27th, each party would exchange  
9 whether there is an additional witness that they  
10 intend to designate as a consequence of the  
11 designations made on the 25th. So that by the 27th  
12 there would be a complete set.

13 That's the --

14 CHAIRMAN VAN LOON: The 27th would also be  
15 if you were dropping anybody from your original list?

16 MR. STEINTHAL: Well, we talked about that  
17 earlier. I think I have to agree with Mr. Garrett  
18 that you should be able to drop people after the 27th.  
19 If it turns out that upon further reflection one can  
20 speed up the process and drop a witness, it shouldn't  
21 be mandatory that you drop by the 27th or you don't  
22 drop at all. And I agree with that.

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1 I think in good faith we ought to let  
2 people know as soon as possible so that we can be as  
3 forthcoming with you about the scheduling requirements  
4 and people don't have to go, you know, do work on  
5 witnesses in terms of preparing for potential  
6 witnesses that aren't going to be called. But to have  
7 a mandatory deadline of dropping people by the 27th,  
8 I agree there might be good reasons why you're making  
9 some decisions on a rolling basis on that.

10 ARBITRATOR VON KANN: So is there a risk  
11 that everybody will want to be safe and make sure that  
12 they've put everybody down on the list that they might  
13 even conceivably have in mind, and therefore, you  
14 know, you'll each put 25 names on your list knowing at  
15 the end of the day you'll probably use 10. And when  
16 we have our call on October 1st, or whatever, to  
17 figure out how many hearing days, we'll be looking at  
18 the list of 50 people or 40 or 30, we'll be looking at  
19 a larger list than is probably realistic.

20 MR. STEINTHAL: There's got to be a  
21 certain amount of good faith here on both sides part.  
22 And I think I know we're going to approach it that

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1 way, and I have every expectation that the RIAA will  
2 as well. I just think it's a question of a lot of  
3 things being considered as you roll into the rebuttal  
4 stage.

5 Yes, there'll be certainly the inclination  
6 to be over inclusive at the beginning and narrow your  
7 focus as you get closer to put in your witness  
8 statements on the 4th.

9 ARBITRATOR GULIN: Was there any talk of  
10 limiting the number of witnesses?

11 MR. STEINTHAL: We haven't talked about  
12 that. And I would think in response to Judge Von  
13 Kann's comment, having the additional one may -- and  
14 I mentioned this the other day, may have the effect of  
15 not being over inclusive in the original designation  
16 as long as you have the ability to designate one more  
17 if there's something that surprises you.

18 ARBITRATOR GULIN: But in terms of the  
19 final list would it be helpful to have a limit on that  
20 so there's not a tendency to load up with 15/20  
21 witnesses that the other side has to prepare for, and  
22 then it turns out you delete 5, 6, 7? I mean, I

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1 understand that there's some implicit good faith here,  
2 but --

3 CHAIRMAN VAN LOON: You may be forgetting  
4 our conversation last night about the other way to  
5 deal with this.

6 ARBITRATOR GULIN: Well, actually I'm not.  
7 That's one way to deal with -- I think that addresses  
8 the idea of time, total time. But I think what I'm  
9 focusing on now is the idea of not causing the other  
10 side to prepare to cross examine a lot of witnesses  
11 that aren't really going to be appearing.

12 MR. STEINTHAL: Judge, I think that we're  
13 going -- I mean, the reality is that we're going to be  
14 so busy until the 4th. I mean, I don't know about  
15 those guys, but it's going to be hard to be preparing  
16 for cross pre issue before the 4th.

17 ARBITRATOR GULIN: Mr. Garrett's planning  
18 vacation.

19 MR. STEINTHAL: So as a practical matter  
20 the 4th is the drop dead date.

21 ARBITRATOR GULIN: Okay.

22 MR. STEINTHAL: And so I don't think it's

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1 a cross prep issue as much as it is a question of  
2 defining how much time we need during the trial.

3 ARBITRATOR GULIN: Well, then I guess  
4 that's assumed from the idea of time limitations.

5 CHAIRMAN VAN LOON: And before you go any  
6 further, Mr. Steinthal, I understood if I caught your  
7 words at the beginning accurately, this was sort of  
8 your thinking and a proposal to Mr. Garrett. And I'd  
9 like to make sure how much of this is agreed by the  
10 parties before we add in a lot of other issues.

11 MR. GARRETT: Well, I think that we agreed  
12 on everything related to the dates that Mr. Steinthal  
13 read off, you know, October 1st through the 15th.

14 CHAIRMAN VAN LOON: That was the original  
15 overall schedule?

16 MR. GARRETT: Right. And I think we're  
17 all on the same page on that one.

18 CHAIRMAN VAN LOON: Right. And you're  
19 agree that they'll go first? I was meaning with  
20 regard to this last topic, witness designation.

21 MR. GARRETT: Right.

22 CHAIRMAN VAN LOON: And using the 25th

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1 adding only one, short description of subject matter  
2 and the 27th as a date whether adding anybody.

3 MR. GARRETT: I agree that we should have  
4 a date where we would exchange the names of our -- of  
5 witnesses and that we would give a two or three  
6 sentence description of the substance of testimony.

7 I agree with what I think -- a statement  
8 Mr. Steinthal made that both sides should make a good  
9 faith designation on that date. We shouldn't be  
10 putting in names of people who we are consciously  
11 intending then to withdraw.

12 You know, I will certainly give on  
13 whatever day we agree upon my best judgment as to who  
14 is going to be the witnesses, and I'm not going to be  
15 intending to withdraw people here unless for some, yo  
16 know, exceptional circumstances that I don't perceive  
17 at that time. But I do think we have to operate in  
18 good faith on that and not simply say I just throw a  
19 list of 100 names on here. That's number one.

20 And I think related to that I would like  
21 the extra days. I would like not to do this until the  
22 27th.

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1 I just know from conversations with the  
2 rest of my team that we have a lot of different things  
3 that people are contemplating right now. And I,  
4 frankly, have to get back there and kind of look what  
5 they've got, what we've got in the record here and  
6 make final judgments. Also to see what kind of  
7 testimony those with whom we've been talking about are  
8 prepared to offer. And I would rather take that  
9 notification date as late as possible, if it's still  
10 consistent with the overall objective here of giving  
11 some advance notice. So, I would still propose the  
12 27th.

13 CHAIRMAN VAN LOON: How do you feel about  
14 the possibility of adding one witness after that date  
15 or those two days?

16 MR. GARRETT: I would prefer not to do  
17 that. I think both sides ought to make the best  
18 judgment as to who they feel is necessary in rebuttal  
19 here and not have that influenced by, you know, the  
20 names that the other side gives them on this  
21 particular date here.

22 In the normal course of things in the

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1 rebuttal phase, you wouldn't find out any of this  
2 information until the date that the rebuttal case had  
3 been filed. And you would have to go forward with  
4 that. But I just -- I just think we both ought to  
5 independently determine what our rebuttal case should  
6 look like and then not change it around to meet some  
7 perceived theories or impressions, or whatever, from  
8 the other side. That's my view.

9 ARBITRATOR VON KANN: I'd be interested in  
10 what both counsel think about Judge Gulin's mention of  
11 a possible witness limit, independent of time limits  
12 at the hearing. We'll talk about that in a minute.

13 Would it be helpful to you? I mean, this  
14 is a little bit like getting to write a brief. When  
15 the Court says it's going to be 50 pages, all right,  
16 that's your perimeters and you all adjust accordingly.

17 Would it be helpful if we had a ground  
18 rule that, you know, each side can call not more than  
19 10 witnesses in rebuttal, or some number?

20 I have been in proceedings where counsel  
21 have welcomed that because it kind of sets a, you  
22 know, overall framework and they both operate within

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1 that framework, and that sort of have been useful.  
2 Other cases people will say no, we prefer to make our  
3 own judgments about that, don't set any limits.

4 MR. STEINTHAL: Let me react to that.  
5 This is not the usual case in so many different ways.  
6 I mean, we have -- I don't know how many parties we  
7 have anymore, but clearly double digit parties on our  
8 side of the table. And there are different  
9 perspectives, I mean, that relate conceivably to NPR  
10 then relate to others, or the religious broadcasters.  
11 And if a client says I want the opportunity to rebut  
12 X, it's very hard. That's why a numerical limit for  
13 this side of the table representing dozens of parties  
14 is a difficult for thing to me to sit here and say  
15 it's okay.

16 Whereas, a time limit we can make or a  
17 page limit, you can prioritized things and make  
18 choices and fit within it without disenfranchising  
19 someone potentially. And that's why the witness limit  
20 to me is a difficult thing to accept.

21 ARBITRATOR VON KANN: Makes sense.

22 MR. GARRETT: If I knew exactly what you

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1 gentlemen were thinking, I'd have no problem. I'd get  
2 two or three witnesses and that's it.

3 The reality is is that we're all kind of  
4 guessing and we may end up having more people than you  
5 really think are necessary because we'll think things  
6 are important to you and, in fact, they aren't.

7 I mean, as I sit here now and just knowing  
8 what the possibilities are out there, I don't know how  
9 we're finally going to come out. I suspect that the  
10 case that I end up submitting on October 4th might be  
11 very different than I if I had to submit it tomorrow,  
12 quite frankly. A lot of that, you know, depends on  
13 going back and reviewing the transcript and talking  
14 with other people.

15 CHAIRMAN VAN LOON: Well, it sounds like  
16 this is another area in which at this point at least  
17 there is consensus in both sides of the room, and you  
18 bring combined decades of years of experiences in  
19 these kinds of proceedings. And that's something we  
20 all respect and honor.

21 MR. STEINTHAL: I think the only issue so  
22 far we've discussed that we disagree on relate to how

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1 soon we designate and whether we have the ability to  
2 have the additional one.

3 CHAIRMAN VAN LOON: Well, let's talk about  
4 the first one. We've got the 25th and the 27th.  
5 There's an obvious --

6 MR. STEINTHAL: We had moved from the 20th  
7 to the 24th the other day, in hopes of reaching an  
8 agreement moved from the 24th to the 25th. So, you  
9 know, by having the move to the 26th, we're sort of --

10 CHAIRMAN VAN LOON: We are betting against  
11 ourself.

12 MR. STEINTHAL: Yes, I've heard that.

13 It just -- again, it depends on one's  
14 perspective. I think that while I appreciate Mr.  
15 Garrett's comment that the later we make the  
16 designation, the more informed we'll be. By the same  
17 token one of the reasons for the designation is to  
18 allow the other side the ability to know what to  
19 expect in terms of witnesses, so that they can  
20 presumably anticipate as fully as they can the kind of  
21 testimony and subject matters that will be brought  
22 before the panel in the rebuttal phase and work with

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1       their witnesses on that basis. And if we wait until  
2       the 27th, essentially 7 days before the witness  
3       statements are going in. So it limits that time  
4       period.

5                   ARBITRATOR GULIN: I suspect a good  
6       mediator would probably at this point offer each to  
7       give a little something. Move the date a little bit  
8       earlier, give up the adding one person to the list.  
9       Is that something you two could live with?

10                   MR. STEINTHAL: The consensus on our side,  
11       I think, would be to do it the other way and, you  
12       know, to move back, for example, from the original of  
13       the 20th to the 26th, and just have the one day in  
14       which to make a decision as to whether there's  
15       anything that jumps off the page that requires us to  
16       add an additional witness by the 27th.

17                   CHAIRMAN VAN LOON: Mr. Garrett, they've  
18       shown some movement. They've proposed a compromise.

19                   MR. GARRETT: Well, there is an intriguing  
20       notion here that you see the other side's list that  
21       you will then be able to get a witness within, you  
22       know, one day to put down.

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1 ARBITRATOR VON KANN: I mean, I assume  
2 that the idea is we've got somebody, do we really need  
3 to put him on? I don't know, probably not. And then  
4 they see your list, and I guess they're going to talk  
5 about that issue, we'd better get Joe in here to talk  
6 about it.

7 MR. GARRETT: Right.

8 ARBITRATOR VON KANN: I don't think you're  
9 going to find a brand new witness at that point. I  
10 would think that's pretty near impossible.

11 MR. GARRETT: So what would the dates be  
12 here?

13 MR. STEINTHAL: The 26th for the  
14 designation and the 27th if there's going to be an  
15 additional one witness.

16 MR. GARRETT: Okay.

17 CHAIRMAN VAN LOON: You can live with  
18 that? Sold. Sold to America.

19 MR. GARRETT: But I expect something in  
20 return for this.

21 CHAIRMAN VAN LOON: Let's go to the next  
22 issue then on your list and we'll keep the score on

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1       how close we are.

2               MR. STEINTHAL:   Okay.   There's the issue  
3       of how to handle the direct examinations.   There was  
4       discussion --

5               ARBITRATOR VON KANN:   Another 10 points.

6               MR. STEINTHAL:   There was the discussion,  
7       and I think it may have come from the panel, as well  
8       as from Mr. Garrett at one point, about the  
9       possibility of going directly to cross examination  
10      from the written direct testimony.

11              We had, as I said the other day, we were  
12      disinclined to agree to that, but suggested instead  
13      that we have time limits on the duration of the direct  
14      for the fact witnesses of the parties.   And I'm going  
15      to underscore the parties because of the Yahoo  
16      possibility, or whoever else might come in and be a  
17      nonparty witness.   I don't think that time limits on  
18      their testimony were what we were contemplating when  
19      we had the discussion.

20              So, when I met with Mr. Garrett this  
21      morning I told him that we would be willing to limit  
22      the direct examinations of fact witnesses to a half an

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1 hour. And frankly make every effort to make it even  
2 shorter than that, but limit it to a half an hour. We  
3 would not propose to have any limits on the expert  
4 direct examinations. And basically, you know, that  
5 was the proposal we made.

6 I think that if I can -- I hope I'm  
7 characterizing this correctly, Mr. Garrett responded  
8 that by October 1st when we have the scheduling  
9 conference, we'll have a much better sense of whether  
10 we really need to have more limitations than that on  
11 the direct or testimonies or other kinds of protocols  
12 for the presentation of evidence to try to meet the  
13 deadline.

14 And I agree with that. I think that we  
15 will have more information by then. We'll know that  
16 the other side's witness lists. And we may be more  
17 willing to accept further limitations than the ones  
18 I've indicated already if we see that the  
19 circumstances warrant it. But as of now, I'm  
20 representing to you the consensus from our side of the  
21 table.

22 MR. GARRETT: Well, my view was simply

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1 that this is an issue that we should take up on  
2 October 1st when we have a better sense of how many  
3 witnesses there are and what's the nature of their  
4 testimony is.

5 If we can -- depending on the number of  
6 witnesses, maybe -- it not necessary to impose those  
7 kinds of limitations. Maybe on the other hand, it's  
8 necessary to impose more stringent limitations. I  
9 just don't know. But I really think that we would  
10 make a better decision on that on October 1st than  
11 right now.

12 That'll also give us a chance of  
13 foreseeing the other side's list on September  
14 26th/27th to see whether or not we did have a  
15 consensus on what ought to be done with the hearings  
16 themselves.

17 But I think there are other issues besides  
18 this, and there would be issues of well, should there  
19 be time limits again. And should those time limits be  
20 calculated differently than the way they've been  
21 calculated so far.

22 I think that's one subject. Another issue

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1 was this business about allowing experts, at least, to  
2 testify about things that weren't in their prepared  
3 statements. And, frankly, I'm not sure -- I don't  
4 think my position's going to change on that between  
5 now and October 1st, but I think all of that ought to  
6 be rolled up in a package together and discussed at  
7 that time if we're not able to reach agreement between  
8 the 27th and October 1st.

9 CHAIRMAN VAN LOON: Part of our thinking  
10 upon reflection late in the day yesterday was that  
11 possibly the way to resolve that one that again gives  
12 you both the maximum flexibility, the maximum decision  
13 making authority on how you want to proceed would be  
14 if we set some very clear time limits defined  
15 differently in a way I'll get to in a second. But if  
16 you knew, for example, that you had 25 hours and that  
17 was sort of your time that you might decide you want  
18 to spend a lot more of it putting on some key one  
19 witness and a lot less in direct of other people, or  
20 you want to save a lot of your time for cross of  
21 somebody else; it would again be a model that would  
22 give you the greatest degree of flexibility and sort

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1 of planning your approach.

2 If we did such a thing, we've learned from  
3 the obvious experience over these past six weeks that  
4 the time keeping model that we've been following has  
5 not been useful. And so we were, in terms of being a  
6 meaningful limit, and so if we went to something like  
7 that it's our feeling that each person's -- each  
8 side's time would be essentially the time that you've  
9 -- if it's direct, you've got it -- anything that  
10 happens during that direct, including the amount of  
11 time that the panelists might ask questions and  
12 including the amount of time that might be given over  
13 to objections and argument on procedural things; that  
14 would all be part of the direct. And similarly, once  
15 cross starts any panel questions that were included or  
16 arguments on procedural matters. Because otherwise  
17 we're keeping time on a basis that ends up being  
18 unrelated to reality and very small amounts of time  
19 each day.

20 That's at least part of our thinking on  
21 this.

22 ARBITRATOR VON KANN: We have never been

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1 entirely clear. In some instances we have had the  
2 impression that our panel questions may have  
3 lengthened witnesses, in some instances some counsel  
4 have said, maybe not be accurate, that we touched on  
5 an area that shortened the exam, and they therefore  
6 didn't have to go into it. So we're not entirely sure  
7 how it all plays out. But it becomes almost  
8 impossible to keep the clock otherwise.

9 So I think that this is like when you have  
10 an appellate argument and if you're given 30 minutes  
11 and the judges pepper you with questions and take 20  
12 of them, that's life. That's the way it works.

13 MR. STEINTHAL: You know, I think if we  
14 look at it in hindsight, if you had done -- if we had  
15 gone back and reallocated the panel question time to  
16 one side or the other on this basis, I think what  
17 you'd probably find is that the ratio would be pretty  
18 much the same. I don't think it's been more than the  
19 other.

20 So, this doesn't -- and not having had an  
21 opportunity to confer with all of my colleagues about  
22 it, the concept of counting time this way it doesn't

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1 trouble me that much as long as we run back in. We  
2 don't have a six hour day, we have essentially a 7 or  
3 8 hour day. Because, you know, we've been going  
4 pretty much 8 full hours a day, sometimes longer, in  
5 terms of court time. And --

6 CHAIRMAN VAN LOON: We've been averaging  
7 between 7½ and 8.

8 MR. STEINTHAL: Yes. And we've had some,  
9 obviously, some half days. But I don't think we're  
10 going to have those in rebuttal. And all I'm saying--

11 CHAIRMAN VAN LOON: And interestingly  
12 enough, the way that the time keeping has gone is that  
13 out of the 20 something day, there's only been one day  
14 where your total time added up to 6 hours. Everything  
15 else was 5 or less. So that's another way of saying  
16 this difference between the old way of keeping time  
17 and the actual amount of time is a disconnect.

18 MR. STEINTHAL: As long as we end up when  
19 we're calculating the time available looking at  
20 essentially 7½ to 8 hour days that are allocated to  
21 the parties over the course of the ten days or  
22 whatever we have, then I don't think I'm going to have

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1 a problem with it unless some of my colleagues do,  
2 sort of looking at it in a different way.

3 CHAIRMAN VAN LOON: Do you have any  
4 reaction to that?

5 MR. GARRETT: Well, I think I can live  
6 with that. I guess I would have done it a different  
7 way. I would have looked at the number of hours that  
8 we actually have been averaging. You know, whether it  
9 may be like 4 hours days. Where you had originally  
10 contemplate 6 hours, maybe it's down to 4. And I  
11 would have kept the old system, but just said 4 hours  
12 a day, we have 10 days. That's 40 total hours, 20 on  
13 each side. And then keep that way.

14 The only advantage I see there is that it  
15 eliminates the potential for abuse of people making  
16 objections or -- I'm getting drawn out. But, you  
17 know, frankly I think that I can -- I think your  
18 system will be fine. And I think it makes sense to  
19 have those time limits.

20 MR. STEINTHAL: I think there are three  
21 people up here that'll make sure that we don't make  
22 objections that are designed to abuse the system.

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1                    ARBITRATOR VON KANN: Mr. Garrett, may I  
2                    just make a comment on your -- you noted that there is  
3                    this issue of the experts commenting on testimony of  
4                    one another. And I agree with you, we should defer  
5                    that for a while. And you all need to talk more about  
6                    it.

7                    But I have a little concern about being  
8                    too strict on that rule. We did it in the direct  
9                    phase, you know, particularly with respect to Nagel.  
10                   We said you'll have a chance to come back in rebuttal.  
11                   But after rebuttal there ain't no coming back. That is  
12                   the last chance we'll hear from these folks. And  
13                   because of the simultaneous filings, there is always  
14                   this ships crossing int he night potential where they  
15                   come up something that your people didn't particularly  
16                   think about, and we'd like to hear what they think  
17                   about it, and conversely.

18                   So whether it comes from questioning of  
19                   one another or from us, I think it's unlikely that if  
20                   one side's team has raised a significant issue, we  
21                   aren't going to be asking the other side's folks about  
22                   that, because it'll be our last chance to hear what

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1 your response is to something that Jaffe has raised,  
2 for example, or vice versa.

3 So, I know -- I agree with you that in the  
4 direct phase it made sense to be a little strict on  
5 that, because there's always a chance to bring them  
6 back. But this is the last chapter -- you know, act.  
7 And so I would be a little nervous about being too  
8 rigid and saying well we never got to hear what Nagel  
9 thought about Jaffe on this point, because Nagel  
10 didn't put it in his direct or something.

11 MR. GARRETT: I have no problem at all in  
12 the panel asking precisely those kinds of questions.  
13 And say look, we read what Nagel had to say, Jaffe,  
14 can you comment on this because it troubles me. I  
15 have no problem at all with that.

16 What concerns me is you do -- somebody's  
17 testimony it's got points A, B, C and D in it. And  
18 then they get up on the stand to start testifying and  
19 counsel starts asking of points E, F, G, H and I. And  
20 I understand if you ask questions, then I've got to  
21 roll with that. And even though I'm not really  
22 necessarily prepared to deal with whatever they say,

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1 you know, that's the way it goes here. But if it's  
2 important to you, then I understand it. But if on the  
3 other hand it's something where -- you know, I don't  
4 even really have to put it all in my written rebuttal  
5 here because I know I can get him to say it and the  
6 other side won't have any notice about it; that just  
7 concerns me.

8 MR. STEINTHAL: Let me address that,  
9 because I don't think that's what we're talking about  
10 here.

11 The only issues that would come up would  
12 be situations like where one expert includes something  
13 in a rebuttal report that's not reasonably anticipated  
14 by the other side. And certainly one can anticipate  
15 in preparing for cross examination of -- if I'm  
16 preparing for Dr. Nagel's cross examination, I can  
17 prepare based on what Dr. Nagel has written as well as  
18 what I know my expert has written that is in his area  
19 of expertise. Because I know it's likely that the  
20 panel may ask or the other side may reasonably ask  
21 questions about a subject matter that falls not within  
22 just the context of what my expert has written, but

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1 what the other experts in his field has written.

2 So it's not -- we're not talking about  
3 things out of all bounds. We're talking about simply  
4 having an expert in his direct testimony, and we'll  
5 use the same examples. If Dr. Nagel puts something in  
6 that, you know, is beyond something that was  
7 reasonably anticipated by any of our economists, and  
8 it's within the area of expertise of our economists,  
9 it doesn't strike me as being terribly surprising to  
10 Mr. Garrett that we would ask our witness, "Look, Dr.  
11 Nagel has said so-and-so, do you have a view regarding  
12 his conclusion reached in that, assuming you have a  
13 foundation for answering it."

14 And it's not a question of trial by  
15 surprise. It's not a question of sandbagging. It's  
16 a question of simply, again, having the opportunity to  
17 have both sides experts who are expert in a certain  
18 area comment on the same subject matters.

19 And, you know, one of the things we  
20 struggled with internally in the last couple of days  
21 on this issue was was there a standard we could apply  
22 to this so that it wasn't boundless. And we sort of

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1 came up with a, for lack of a better standard, a good  
2 cause shown standard. That if a party could show  
3 good cause, i.e., that there was no way of really  
4 reasonably anticipating that the other side's expert  
5 was going to cover a certain subject matter, then they  
6 ought to be able to react to that subject matter  
7 through their own expert if he's expert in that area.  
8 But it's not an invitation to go on a folic and a  
9 detour and expand direct beyond that kind of  
10 situation.

11 Now maybe, you know, we can talk about  
12 this again on the 1st as Mr. Garrett suggested and  
13 Judge Von Kann suggested. But we do think, and I echo  
14 Judge Von Kann's sentiments here, it is the last  
15 hurrah. And nobody's trying to sandbag anybody here.  
16 It's just a question of having the economists that  
17 have spent a lot of time on these issues, and if  
18 there's a spur issue that comes up that wasn't  
19 anticipated, not within the subject matter we talked  
20 about in the direct part of the case, it just seems  
21 artificial to allow one side's expert to come up the  
22 new theory, come up with the new spur, whatever it

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1 might be. And even if it's within the same expertise  
2 of the other side's expert, sort of keep that expert  
3 mum.

4 Now maybe the panel will ask the question.  
5 But maybe it won't. And it just seems artificial not  
6 to be able to ask that expert if he has a reaction to  
7 what the other side's experts in that area say.

8 So it's very limited thinking that we're  
9 talking about.

10 ARBITRATOR VON KANN: One thing you could  
11 do, I'm not necessarily -- this might be too much  
12 work. But your comment if he has a reaction to  
13 something, and then I'm assuming that when these  
14 things come in on the 4th you're going to ship them to  
15 our expert and they're going to read each other's  
16 testimony.

17 MR. STEINTHAL: Absolutely.

18 ARBITRATOR VON KANN: That's bound to  
19 happen. We could have a rule that says if you want to  
20 call upon your expert to critique or react, or comment  
21 on something, then you've got to give something to the  
22 other side by October 15th.

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1 MR. STEINTHAL: I have no problem with  
2 that.

3 ARBITRATOR VON KANN: You know, if Dr.  
4 Jaffe will also address these three points made by Mr.  
5 Nagel and we'll say essentially the following.

6 MR. STEINTHAL: No problem with that  
7 whatsoever.

8 ARBITRATOR VON KANN: So you at least have  
9 some idea of what's coming.

10 ARBITRATOR GULIN: I was just going to  
11 make sure that I understand Mr. Steinthal's proposal,  
12 which seems in a fairly narrow -- it seems like this  
13 would occur in a fairly narrow area. And that is only  
14 when opposing expert raises a new theory.

15 MR. STEINTHAL: Yes. That's basically it.

16 ARBITRATOR GULIN: Yes.

17 MR. STEINTHAL: Or a new expert comes in  
18 with a new study or theory, yes.

19 CHAIRMAN VAN LOON: Well, it seems like  
20 this has been a useful sort of airing of the issues  
21 and a further refinement. I think that there's  
22 agreement all the way around that we shouldn't resolve

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1 that today, that we should wait until the 1st, give  
2 you time to think about it more, to discuss. Maybe  
3 some of these off-the-top-of-the-head kinds of ideas  
4 might be incorporated into something that would be  
5 mutually acceptable. If not, we'll deal with them on  
6 the 1st.

7 MR. STEINTHAL: The only other issue on my  
8 list, since we've covered in things in whatever order  
9 we've gotten to them, is the question of the third  
10 party witnesses. And the question that arose  
11 yesterday as to whether there would be a requirement  
12 that a third party witness put in a written witness  
13 statement.

14 We conferred among our group, conferred  
15 with Mr. Garrett this morning, and I think the  
16 consensus is that if the panel is willing to allow a  
17 nonparty witness to testify without a written witness  
18 statement, then we're willing to consent to that  
19 approach.

20 ARBITRATOR VON KANN: Do you have the  
21 impression that would make it easier for some of these  
22 third party witnesses to appear?

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1 MR. STEINTHAL: Only as a scientist of  
2 human nature after all these years, I'd say the answer  
3 is very much yes. I mean, whether it's a small  
4 company or person that doesn't have a lot of time, or  
5 a big company that has layers and layers of, you know,  
6 review that seems to have to happen before somebody  
7 puts in a witness statement. I think either way a  
8 written witness statement adds layers of complexity.  
9 And if there's no subpoena power and the choice is  
10 gee, I don't have to do -- I don't have to come there  
11 and if I do have to put in a written witness  
12 statement, I think putting in a witness statement is  
13 an additional burden, whether it be a legal burden or  
14 a manpower burden, I think it's a burden that some  
15 companies may resist.

16 ARBITRATOR VON KANN: If one were to  
17 permit that to happen, the witness to come in without  
18 a prepared statement, how would you envision the  
19 questioning of that witness to occur?

20 MR. STEINTHAL: Well, my thought on that  
21 is one of two different ways, which is either the  
22 panel -- I mean, I assume we're limiting this to the

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1 26 licensees at this point and we're not inviting  
2 third party witnesses --

3 ARBITRATOR VON KANN: I think that's what  
4 we were talking about. You assume it's a much smaller  
5 number in reality than could exist.

6 MR. STEINTHAL: Right. But in that event  
7 we could do one of two things. I mean, the panel has  
8 shown no unwillingness --

9 ARBITRATOR VON KANN: We've very timid  
10 questioning. A very timid group.

11 MR. STEINTHAL: So one way of doing it is  
12 to have the panel ask questions and then have the  
13 parties be able to examine the witnesses, and perhaps,  
14 you know, alternate -- you know, I don't know how many  
15 of these witnesses we'll have. Maybe this is an  
16 entirely hypothetical discussion, like some of our --  
17 some of the theories we've heard. But, you know, we  
18 could alternate as to who gets the first questioning  
19 of those witnesses.

20 I mean, that's one way of doing it. And  
21 the other way would simply be, again, to just have one  
22 of the parties, you know, alternate, if you will, in

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1 asking the questions of the witness.

2 Now, I'm assuming that if the invitation  
3 is made, all however many of these companies that may  
4 testify will choose the option of not putting in a  
5 written witness statement. If they choose to put in  
6 a written witness statement, then presumably they're  
7 going to have counsel helping them on that, and they  
8 may have their own counsel ask them questions.

9 And I think that, you know, if there's an  
10 independent counsel that wants to come in, I would be  
11 frankly surprised if a company as sophisticated as a  
12 Yahoo or even some of the other companies that are not  
13 as sophisticated came here without their own counsel.  
14 And it may be that they have their own counsel walk  
15 them through a direct testimony, and then we just all  
16 three, the panel, the RIAA and we get to ask questions  
17 of the witness. But I think we have to consider the  
18 possibility that there will be counsel representing  
19 these companies and that they may want to sort of have  
20 some degree of control over the proceeding by asking  
21 the direct.

22 ARBITRATOR GULIN: Assuming we agree with

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1 that, that we're not going to require any kind of  
2 witness statement, a written statement, how would you  
3 envisage that we communicate that to them? Would you  
4 envisage us issuing another order or is that something  
5 that you would communicate?

6 MR. STEINTHAL: I think it's probably  
7 better so that we don't get in a situation where  
8 either party is responsible for communicating the  
9 wishes of the panel or the orders of the panel to that  
10 group -- to that universe that the panel issue an  
11 order inviting any of the 26 licensees to testify and  
12 indicating that they'll not be required to provide a  
13 written witness statement in advance of that.

14 I mean, obviously, we're going to have  
15 come up with a notice mechanism. I think we're all  
16 three of us, you , we and the RIAA, will want to know  
17 in advance who is testifying and the reality is that  
18 the RIAA has had communications with Yahoo. You know,  
19 my first represents Launch and has communications with  
20 Yahoo since the Yahoo Launch deal occurred. So we may  
21 be communicating with different people, but beyond  
22 Yahoo, however, I will say that, you know, there's

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1 less likelihood that we have the relationships, if you  
2 will, to have communications on an ongoing basis with  
3 those 26, other than Music which we represented  
4 previously as well.

5 CHAIRMAN VAN LOON: What are your thoughts  
6 on this, Mr. Garrett?

7 MR. GARRETT: Well, I think an order would  
8 probably -- maybe not characterized as an order, but  
9 some statement from the panel would probably be  
10 useful. And you could communicate both that you would  
11 welcome their testifying, would not be necessary to  
12 have a written statement, but they would need to  
13 notify the panel at least, and the parties, by -- you  
14 know, like by a date certain so that we all have some  
15 advance notice whose going to walk in during those  
16 hearings.

17 We're going to have to make some  
18 adjustment, too, of the hearing days to accommodate  
19 them. You know, when they might be able to testify  
20 and how that relates to all the other witness.

21 You know, I think some kind of statement  
22 from the panel that both sides could take it upon

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1 themselves to send to the different licensees would be  
2 fine. Would be helpful.

3 ARBITRATOR GULIN: Would it be appropriate  
4 for maybe the two of you to get together and draft  
5 such a statement or order.

6 MR. GARRETT: Sure.

7 CHAIRMAN VAN LOON: And do you think it  
8 should be characterized as an order or an invitation,  
9 or in letter form, or --

10 MR. GARRETT: I don't know, but we will  
11 figure out something. I think order is probably the  
12 wrong word for it.

13 ARBITRATOR GULIN: I do, too. Let me say  
14 this about that. I think in the original order we  
15 talked about -- apparently we did talk about a written  
16 statement. So it may be appropriate to issue a  
17 modified or an order modifying that portion of the  
18 prior order. That might be the way to handle it.  
19 But, you know, use your imagination, I guess.

20 ARBITRATOR VON KANN: It might be better  
21 to have two different documents. A very brief order,  
22 the panel hereby orders that the attached notice be

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1 sent to all the parties. And we modify the  
2 requirement of the written statement and then there'd  
3 be a separate stand alone document -- I don't know,  
4 called a notice or an invitation or something that  
5 would be sent to them.

6 MR. STEINTHAL: The question will be how  
7 many returned to senders do you get.

8 MR. GARRETT: As many as we get when we  
9 service on your original service.

10 ARBITRATOR VON KANN: Do you think we need  
11 responses to that by the October 1st date if you're  
12 going to have this conference --

13 MR. STEINTHAL: Yes, to make the October  
14 1st date as informed a conversation as we can.

15 ARBITRATOR VON KANN: You need it a few  
16 days before that then, which really means getting this  
17 out pretty quick because you're talking about --

18 MR. STEINTHAL: Well, I think we should  
19 work on this, you know, by the end of this week. And  
20 we've got this afternoon without any witnesses. Maybe  
21 we can try to spend sometime getting it done.

22 ARBITRATOR VON KANN: If you get something

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1 out on the 10th or 11th and give them 2 weeks or  
2 something to respond, that's the 25th or 26th.

3 MR. STEINTHAL: We'll put it on the phone  
4 list.

5 CHAIRMAN VAN LOON: Right. Well, today's  
6 the 6th. Well, the end of the week is tomorrow. If  
7 you could do it very quickly, very early next week and  
8 by the 26th or 27th to get back to us, that should  
9 work.

10 MR. STEINTHAL: That concludes what was on  
11 my list.

12 CHAIRMAN VAN LOON: Very substantial  
13 overlap, although characterized differently. But we  
14 certainly got an answer to all seven on our list.  
15 Excellent.

16 Are there any other aspects of thinking  
17 about rebuttal that we need to consider?

18 MR. GARRETT: Nothing that I can think of  
19 at this time.

20 CHAIRMAN VAN LOON: Okay. Well then,  
21 let's allow everyone to escape for the afternoon, and  
22 we'll come back tomorrow with NPR day and those two

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1 witnesses.

2 ARBITRATOR VON KANN: Do counsel feel that  
3 the discussion we had today is sufficiently final that  
4 we should reduce or memorialize this in some way in an  
5 order? Not the pieces that haven't yet been settled,  
6 there's some pieces to be settled, but would it be  
7 desirable to do that?

8 MR. GARRETT: Sure.

9 CHAIRMAN VAN LOON: We can do that.

10 Then we will see everyone tomorrow morning  
11 at 9:00.

12 ARBITRATOR GULIN: Have a nice afternoon.

13 (Whereupon, at 1:26 p.m. the hearing was  
14 adjourned, to reconvene tomorrow morning at 9:00.)  
15  
16  
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CERTIFICATE

This is to certify that the foregoing transcript in  
the matter of:           Hearing: Digital Performance Right  
                              in Sound Recording and Ephemeral  
                              Recording,  
                              Docket No. 2000-9 CARP DTRA 1 & 2

Before:                   Library of Congress  
                              Copyright Arbitration Royalty Panel

Date:                     September 6, 2001

Place:                    Washington, DC

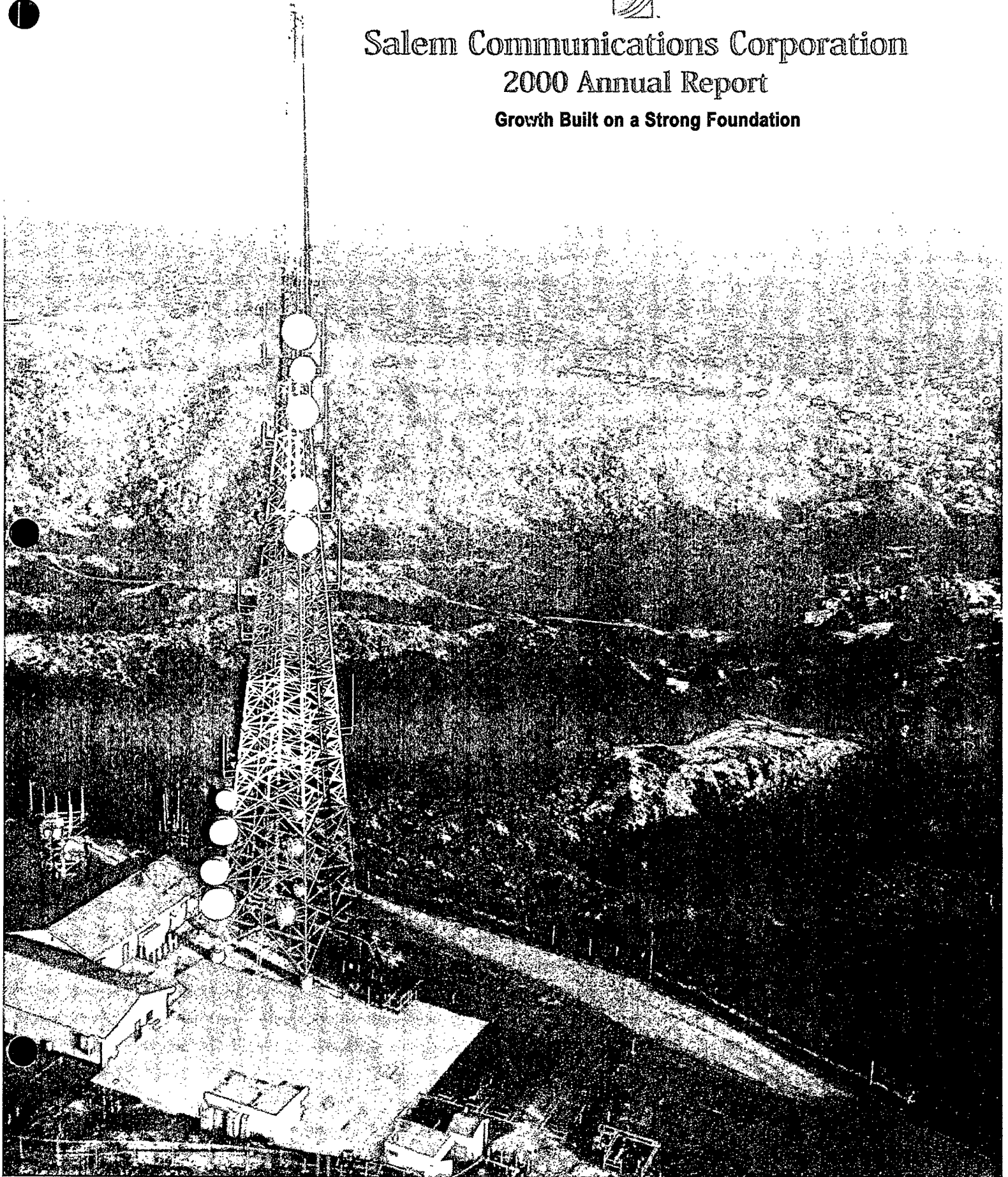
represents the full and complete proceedings of the  
aforementioned matter, as reported and reduced to  
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# Salem Communications Corporation 2000 Annual Report

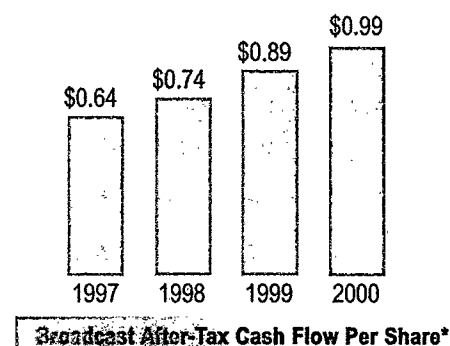
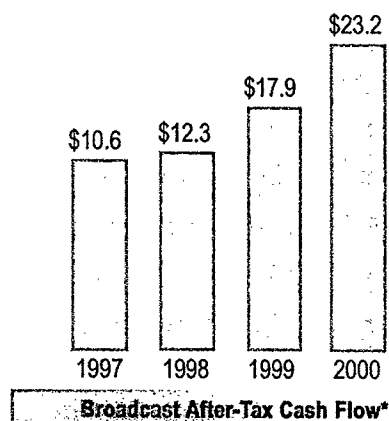
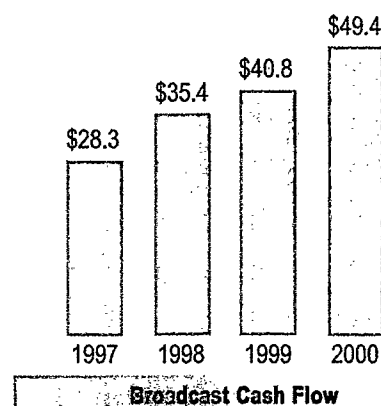
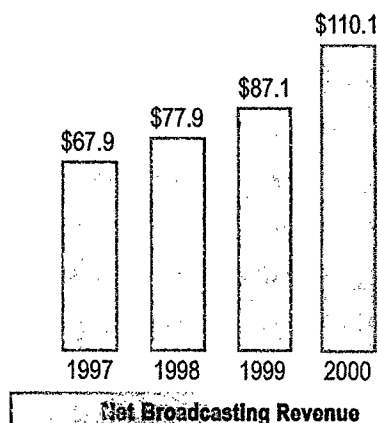
**Growth Built on a Strong Foundation**



## About The Company

Salem Communications Corporation is the leading provider of Christian and family-friendly radio content; content which is compelling to the religious and family issues audience segment. Our core business strategies are to continue in our leadership position within the industry and to enhance the effectiveness of our distribution channels. To this end, and after the completion of all announced transactions, we will own and operate 76 radio stations in 34 radio markets, with 53 radio stations in 22 of the top 25 radio markets and 62 radio stations in the top 50 radio markets. We also own and operate Salem Radio Network, a national radio network which syndicates over 86 hours of daily original talk, news and music programming to over 1,400 affiliated radio stations, and Salem Radio Representatives, a company specializing in the sale of national advertising to our core audience. In addition to our foundations in radio broadcasting, we also own *OnePlace.com*, the largest provider of Christian radio content over the Internet, and CCM Communications, publisher of *CCM Magazine*, the leading magazine following the Contemporary Christian Music industry.

## Financial Highlights



	1998	1999	Annual % Change	2000	Annual % Change
Net Broadcasting Revenue	\$ 77.9	\$ 87.1	12%	\$ 110.1	26%
Other Media Revenue	—	6.4	N/A	7.9	23%
Total Revenue	77.9	93.5	20%	118.0	26%
Broadcast Cash Flow	35.4	40.8	15%	49.4	21%
Broadcast EBITDA*	28.0	32.3	15%	39.0	21%
Broadcast After-Tax Cash Flow*	12.3	17.9	46%	23.2	30%
Broadcast After-Tax Cash Flow Per Share*	\$ 0.74	\$ 0.89	20%	\$ 0.99	11%
<b>Same Station Results:</b>					
Net Broadcasting Revenue		\$ 64.6		\$ 72.7	13%
Broadcast Cash Flow		29.8		34.4	15%
Broadcast Cash Flow Margin		46%		47%	

\*Excludes Non-Broadcast Media

(dollars in millions, except per share data)

We are pleased to highlight the continued growth of our national businesses, Salem Radio Network and Salem Radio Representatives. With the station acquisitions of the past two years, our national businesses have truly reached critical mass and we are seeing very strong growth from this segment of our business.

We would be remiss if we did not comment on our Internet business. We bought *OnePlace.com* in 1999, knowing that it could be a strategic complement to our radio business. Like many companies in 2000, we soon learned that the euphoria of the Internet was not enough to sustain a profitable Web-based company. Early in the year we refocused our Internet strategy to pursue more closely a complementary role to our existing radio operations—a strategy with a more clear and quicker path to profitability. Now *OnePlace.com* operates much like our Christian Teaching & Talk radio stations do, selling to ministries the opportunity to distribute their programs over the Internet and, at the same time, selling advertising. As a result, we have substantially reduced the cost base of our Internet business and expect to reach profitability in the fourth quarter of 2001.

In light of 2000 being a year of significant growth and change, if there was ever a time for us to express profound gratitude to the employees of Salem Communications, it is now. Our employees experienced an unprecedented workload in 2000 and yet they continually rose to the demands. In order to effectively manage our significantly expanded business, we made it a high priority in 2000 to continue the expansion and strengthening of our management team. To this end we created four new Senior Vice President positions, including that of our new CFO, David Evans.

We are enthusiastic about the upcoming year and look forward to continually meeting and exceeding our financial and strategic goals. Thank you for your support, and we look forward to continuing to share our success with you.



Edward G. Atsinger III  
PRESIDENT AND CHIEF EXECUTIVE OFFICER

Stuart Epperson  
CHAIRMAN OF THE BOARD





## To Our Shareholders, Customers and Employees

Despite the slowing economy, 2000 was a year of significant growth for Salem Communications. With your help, Salem Communications remains the undisputed leader in the distribution of religious and family issues radio content. Financially, we were able to grow our revenues, broadcast cash flow and after-tax cash flow by 26%, 21% and 20% respectively. Equally important, because of the achievements in 2000 and in previous years, Salem Communications has built a national radio platform that will serve as the foundation for continued growth in its operations. As you read this letter, the attached report and the financial results of our 2000 operations, we trust that you too will share our enthusiasm, not just for all that was accomplished in the year, but for how well those accomplishments prepare the company for future expansion, development and growth.

Our business strategy has always been to expand and improve our national platform in order to deliver compelling content to the audience interested in religious and family issues. This year was no different. In 2000, we significantly added to the radio station assets of the company by expanding operations in 16 of the top 50 markets. We also continued our development of two new radio formats (The Fish™ and Conservative News/Talk) which complement our primary Christian Teaching & Talk format. In addition, we added significant strength to our management team. We believe these developments will provide the foundation for Salem Communications' future successes.

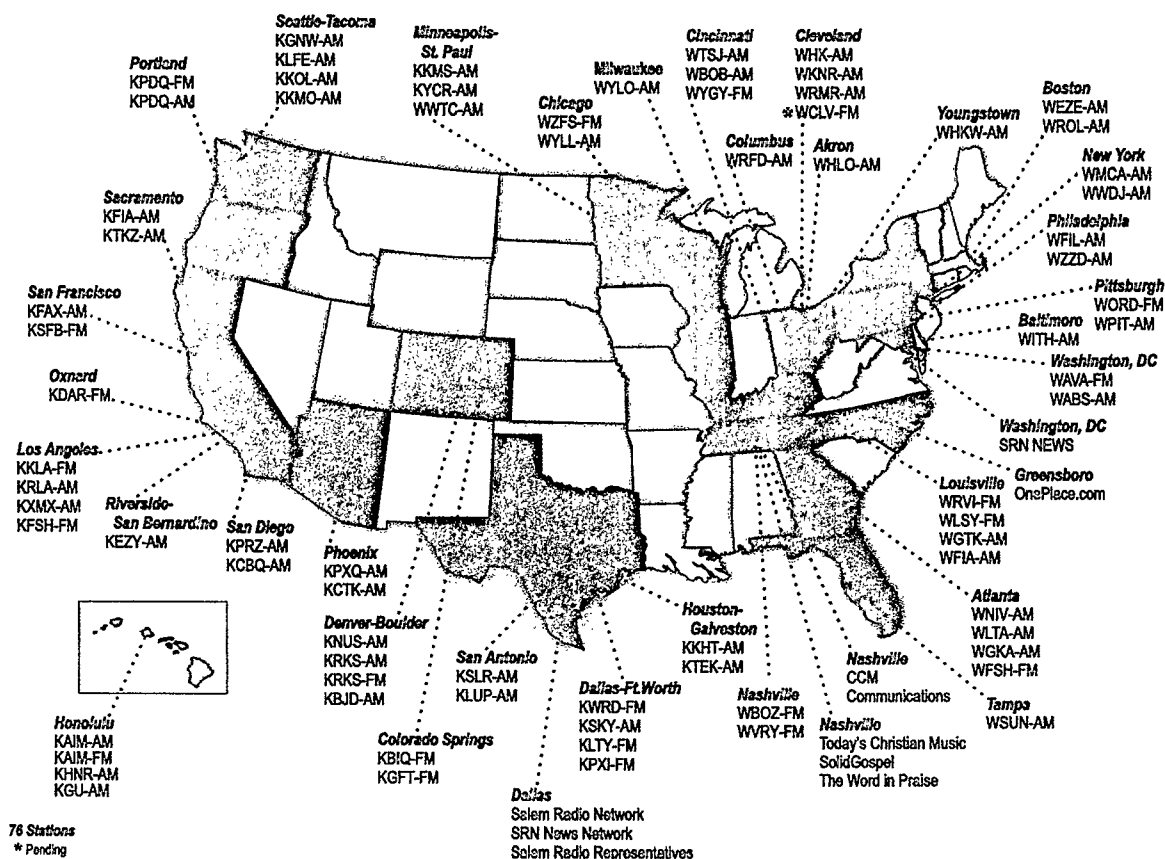
Perhaps the largest single event in the history of Salem Communications occurred in 2000, when the company acquired eight radio stations from Clear Channel Communications for \$185.6 million. An opportunity to acquire such significant radio station assets in a single acquisition may never occur again. Radio consolidation has now reached a point where there are almost no radio properties available in the top 25 radio markets. However, as a result of the Clear

Channel acquisition and other strategic acquisitions in the year, Salem Communications continued to assemble a national platform of high quality radio stations.

We find great satisfaction in our concentrated ownership of radio stations in the top 50 markets because in doing so we are able to efficiently broadcast to over 55% of the population of the country. In markets where we have more than one radio station, we are able to achieve certain efficiencies that both reduce operating costs and increase revenue opportunities. Thus, we firmly believe that our radio station assets are a key foundation to the future growth of the company.

As important as our premier radio facilities are to us, our Christian Teaching & Talk format is foundational to the Company. This format is both who we are as a company and why we succeed. The hallmark of this format is the need for a proven long-term commitment to it, and the benefit of such a commitment is the opportunity for sustained growth. It is this part of our business where we are most thankful for the strong, longstanding relationships we have with our customers. Some of these customers have been a part of our company from its inception.

It is because of the success of our foundational format, and our commitment to further its success, that we built two new formats: The Fish™, a Contemporary Christian Music format, and Conservative News/Talk. Both of these formats are consistent with our strategy of delivering compelling content to our audience – the radio listener interested in religious and family issues. Our strategy of developing Christian Music radio stations represents our single largest growth initiative for the next several years. We are very pleased with the early ratings success of these new stations and are confident that this initiative will prove a strong financial success over the coming years.



## The Foundations of Our Business

### Salem Communications – The Market Leader in Providing Religious and Family Issues Content

Leveraging our national broadcasting platform with our print and Internet assets, we have built a company that is the undisputed leader in reaching the radio audience interested in religious and family issues.

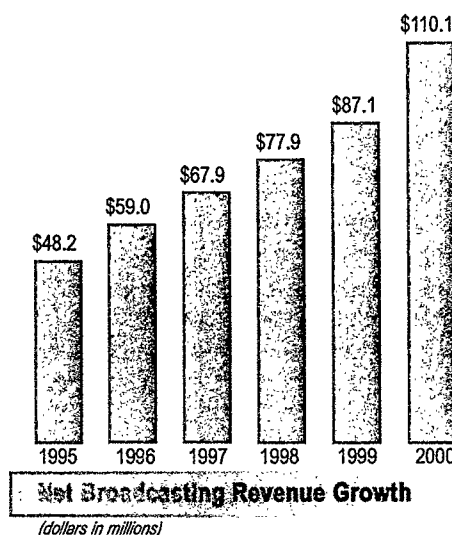
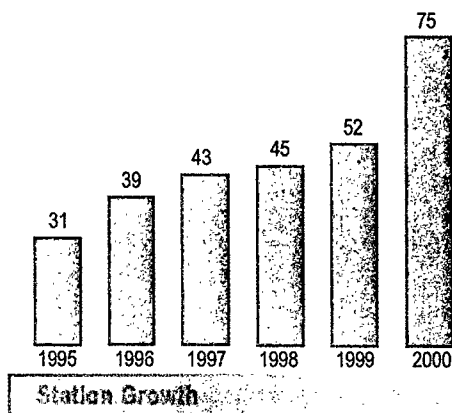
#### Radio Stations

We have one of the strongest radio platforms in the broadcasting industry. After completion of pending transactions, Salem Communications will own and operate 76 stations in 34 markets, including 53 in 22 of the top 25 radio markets and 62 in the top 50 radio markets. FCC licenses, particularly in the top 50 radio markets, are limited; however, in 2000 we enhanced our portfolio by adding 27 radio stations in total and 22 in the top 50 radio markets. In our opinion, the importance of these acquisitions cannot be overstated. Radio consolidation has now reached a point where there are very few radio properties available in the top

25 markets. With 53 radio stations in top 25 markets, Salem Communications ranks third behind only Clear Channel and Infinity in terms of such presence. We can therefore confidently state that Salem Communications owns some of radio's best "beachfront" property.

#### Christian Teaching & Talk Format

Our Christian Teaching & Talk format, as well as generating advertising revenue, derives substantial revenues from the sale of uninterrupted blocks of broadcast time (usually in 26 or 55 minute increments) to groups or entities desiring an opportunity to broadcast to a community interested in the content of their message. We have over 120 national ministries purchasing broadcast time from us in this manner. This block programming business represents 80% of the broadcast day on stations with this format and over 40% of our total revenues.



These revenues are stable, predictable and, we believe, less likely to suffer a significant setback during a recession. Block programming is inherently long-term in nature because of the critical importance of stable radio exposure to the survival and growth of these customers. Cancellations have been and continue to be rare. As a result, we have relationships with our block programming customers that date back over 25 years. In addition, our contracts are negotiated annually, setting the pricing and broadcast times in advance, allowing us to more easily regulate available inventory and predict our revenues and cash flow for the coming year.

### **Solid Leadership**

Salem Communications has developed a strong and seasoned management team. Our Chairman, Stuart W. Epperson, and our Chief Executive Officer, Edward G. Atsinger III, each have operated radio stations for in excess of thirty years. Collectively, our other radio executives have an average of more than twenty-five years of experience managing radio operations. Our Operations Vice Presidents, some of whom are also General Managers of radio stations, oversee several markets on a regional basis. This team has consistently delivered very solid financial performance. In 2000, we were fortunate to hire David Evans, our new Senior Vice President and CFO. We also named Joe Davis as Senior Vice President of Radio Operations and hired George Toulas as Senior Vice President of Special Projects, with specific responsibility for the launch of our new music-formatted radio stations.

---

*"Like a man building a house, who dug down deep and laid the foundation on rock, when a flood came, the torrent struck that house but it could not shake it because it was well built."*

*Luke 6:48*

6. SALM

**Our Formats****CHRISTIAN TEACHING & TALK**

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 Los Angeles<sup>®</sup>  
 Chicago<sup>®</sup>  
 San Francisco<sup>®</sup>  
 Philadelphia<sup>®</sup>  
 Dallas<sup>®</sup>  
 Boston<sup>®</sup>  
 Washington<sup>®</sup>  
 Houston<sup>®</sup>  
 Atlanta<sup>®</sup>  
 Seattle/Tacoma<sup>®</sup>  
 San Diego<sup>®</sup>  
 Phoenix<sup>®</sup>  
 Minneapolis<sup>®</sup>  
 Baltimore<sup>®</sup>  
 Pittsburgh<sup>®</sup>  
 Denver<sup>®</sup>  
 Cleveland<sup>®</sup>  
 Portland<sup>®</sup>  
 Cincinnati<sup>®</sup>  
 San Bernardino<sup>®</sup>  
 Sacramento<sup>®</sup>  
 Milwaukee<sup>®</sup>  
 San Antonio<sup>®</sup>  
 Columbus<sup>®</sup>  
 Louisville<sup>®</sup>  
 Honolulu<sup>®</sup>  
 Akron<sup>®</sup>  
 Colorado Springs<sup>®</sup>  
 Oxnard<sup>®</sup>

**CONSERVATIVE NEWS/TALK**

Los Angeles<sup>®</sup>  
 Seattle<sup>®</sup>  
 San Diego<sup>®</sup>  
 Tampa<sup>®</sup>  
 Phoenix<sup>®</sup>  
 Sacramento<sup>®</sup>  
 Honolulu<sup>®</sup>

**THE FISH<sup>™</sup> & MUSIC FORMATS**

Los Angeles<sup>®</sup>  
 Chicago<sup>®</sup>  
 San Francisco<sup>®</sup>  
 Dallas<sup>®</sup>  
 Atlanta<sup>®</sup>  
 Cleveland<sup>®</sup>  
 Cincinnati<sup>®</sup>  
 Louisville<sup>®</sup>  
 Honolulu<sup>®</sup>  
 Colorado Springs<sup>®</sup>

® Market operates in a cluster

**Growth Strategies:****Radio****CLUSTERING**

Salem Communications' acquisition strategy is focused on developing clusters of radio stations in the top 50 radio markets. In effectuating this strategy, we increase the efficiencies of our radio stations by taking advantage of cross-selling and cross-promotion opportunities, as well as reduced costs through consolidated operations. This is one way we improve our station performance. It also allows recently acquired radio stations that are in a start-up or development phase of their life cycle to more rapidly improve their operating cash flow. We will continue to acquire additional radio stations to further improve profitability.

**COMPLEMENTARY FORMATS****The Fish<sup>™</sup> – Contemporary Christian Music**

Our Contemporary Christian Music formatted radio stations represent our single largest growth initiative for the next several years. Christian music, in terms of album sales, has grown by an average of 16% per year over the past 10 years and now represents the sixth largest music genre. In response to this demand, we have launched stations with The Fish<sup>™</sup> format in a number of cities, including Dallas, Atlanta, Los Angeles, Chicago, and shortly, Cleveland. This music is a major attraction to general market advertisers due to its ability to draw listeners from all walks of life.

**Conservative News/Talk**

The Conservative News/Talk format also builds on foundations laid in earlier years. This format has strong appeal to our core audience and also provides the Company the opportunity to showcase the content of our network, Salem Radio Network (SRN), both reducing the overall costs of operating the radio station and increasing sales opportunities for the radio station and our national sales company, Salem Radio Representatives (SRR). In fact, with the significant growth in station acquisitions and the expansion of this new format, SRN and SRR represent very strong opportunities for growth in the years to come.



## National Sales

### Salem Radio Network

Salem Radio Network (SRN) has grown to become the largest full-service network serving our audience. SRN currently has over 1,400 affiliated radio stations.

The network is divided into three areas, SRN Talk, SRN News and SRN Music. SRN Talk produces over 14 hours daily of original programming mostly in the form of live call-in talk shows. Each show is relevant, informational and confronts the issues of the day. Our talk show hosts include Michael Medved, Hugh Hewitt, Janet Parshall and Dennis Prager. SRN News offers a comprehensive news package that is grounded in a Judeo-Christian worldview. Twenty-four hours, every day of the week, SRN Music provides 3 channels of Christian music, a high-quality, low-cost method of programming for our affiliates broadcasting music formats. Our music formats include: Contemporary Christian Music, Gospel Music and Praise Music and are branded as Today's Christian Music, Solid Gospel and The Word in Praise.

The availability of SRN's content menu provides us with programming and cost benefits, particularly with recently acquired radio stations, where we can quickly and economically program the station with existing network content.

### Salem Radio Representatives

Salem Radio Representatives (SRR) is the only firm specializing in bringing national advertising dollars to radio stations

broadcasting to a radio audience interested in religious and family issues. Accordingly, SRR sells all national commercial advertising placed on over 300 affiliated stations, including Salem Communications' owned and operated radio stations.

## Non-Broadcast Media

### OnePlace.com

*OnePlace.com* is the leading provider of religious and family issues audio programming on the Internet, either through the OnePlace website or through our local radio station websites. Our strategy centers on OnePlace serving as both a complement to and extension of the Company's core radio broadcasting business. OnePlace provides a single location where our customers can listen to any of our radio stations. As with our core radio business, our Internet model is to produce revenues through advertising and programming fees. The business model is similar to our radio model with a combination of advertising sales and block programmers paying to have exposure on our websites. OnePlace links to Salem Communications' radio station websites, allowing for content sharing, providing an efficient and cost effective means of cross-promotion and extending the reach of radio advertising.

### CCM Communications

We have extended our leadership in the distribution of Christian content through print media as well. CCM Communications was established in 1978 and now has five consumer and trade publications focused on the Christian music industry. Its combined readership exceeds 330,000.

The flagship publication is *CCM Magazine*, a monthly consumer magazine with a circulation of approximately 55,000 per month. CCM Update is a weekly trade magazine for record companies, radio station and Christian bookstores, which highlights new music releases. Other publications include *Worship Leader* and *Youthworker Journal*.

*"I planted, the workers watered,  
but God gave the growth."  
The Apostle Paul*

## NEWS:

*SRN News Network*

*SRN News - Sports Report*

*SRN News - Business Report*

*Faith Beyond the Game*

*Global Landscape*

## TALK:

*The Michael Medved Show*

*The Hugh Hewitt Show*

*Janet Parshall's America*

*The Dennis Prager Show*

*Tim Kimmel Live!*

*The Cal Thomas Commentary*

*Eye On Entertainment*

*Dawson McAllister Live*

*Homeschool Helper*

## MUSIC:

*Today's Christian Music*

*The Word in Praise*

*Solid Gospel*

*The CCM Radio Magazine*

*Spin 180*

*Let Us Worship*

*Realtime*

## SELECTED CONSOLIDATED FINANCIAL INFORMATION

Salem's selected historical statement of operations and balance sheet data presented below as of and for the years ended December 31, 1996, 1997, 1998, 1999 and 2000 are derived from the audited consolidated financial statements of Salem. The consolidated financial statements as of December 31, 1999 and 2000 and for each of the years in the three-year period ended December 31, 2000, and the independent auditors' report thereon, are included elsewhere in this report. Salem's financial results are not comparable from period to period because of our acquisition and disposition of radio stations and our acquisition of other media businesses. The selected consolidated financial information below should be read in conjunction with, and is qualified by reference to, our consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this report.

	Year Ended December 31,				
	1996	1997	1998	1999	2000
	<i>(Dollars in Thousands Except Per Share Data and Ratios)</i>				
Statement of Operations Data:					
Net broadcasting revenue	\$ 59,010	\$ 67,912	\$ 77,891	\$ 87,122	\$ 110,097
Other media revenue	—	—	—	6,424	7,916
Total revenue	59,010	67,912	77,891	93,546	118,013
Operating expenses:					
Broadcasting operating expenses	33,463	39,626	42,526	46,291	60,714
Other media operating expenses	—	—	—	9,985	14,863
Corporate expenses	4,663	6,210	7,395	8,507	10,457
Stock and related cash grant	—	—	—	2,550	—
Tax reimbursements to S corporation shareholders(1)	2,038	1,780	—	—	—
Depreciation and amortization	8,394	12,803	14,058	18,233	25,479
Total operating expenses	48,558	60,419	63,979	85,566	111,513
Net operating income	10,452	7,493	13,912	7,980	6,500
Other income (expense):					
Interest income	523	230	291	1,005	534
Gain (loss) on disposal of assets	16,064	4,285	236	(219)	29,567
Interest expense	(7,361)	(12,706)	(15,941)	(14,219)	(17,452)
Other expense	(270)	(389)	(422)	(633)	(857)
Total other income (expense)	8,956	(8,580)	(15,836)	(14,066)	11,792
Income (loss) before income taxes and extraordinary item	19,408	(1,087)	(1,924)	(6,086)	18,292
Provision (benefit) for income taxes	6,655	106	(343)	(1,611)	6,996
Income (loss) before extraordinary item	12,753	(1,193)	(1,581)	(4,475)	11,296
Extraordinary loss(2)	—	(1,185)	—	(3,570)	(1,187)
Net income (loss)	\$ 12,753	\$ (2,378)	\$ (1,581)	\$ (8,045)	\$ 10,109
Pro forma net income (loss)(1)	\$ 12,838	\$ (770)			
Basic and diluted income (loss) per share before extraordinary item	\$ 0.77	\$ (0.07)	\$ (0.09)	\$ (0.22)	\$ 0.48
Basic and diluted net income (loss) per share(3)	\$ 0.77	\$ (0.14)	\$ (0.09)	\$ (0.40)	\$ 0.43
Pro forma basic and diluted income (loss) per share before extraordinary item	\$ 0.77	\$ 0.02			
Pro forma basic and diluted net income (loss) per share	\$ 0.77	\$ (0.05)			
Basic weighted average shares outstanding(3)	16,661,088	16,661,088	16,661,088	20,066,006	23,456,088
Diluted weighted average shares outstanding(3)	16,661,088	16,661,088	16,661,088	20,066,006	23,466,849

## Other Data:

Broadcast cash flow(4)	\$ 25,547	\$ 28,286	\$ 35,365	\$ 40,831	\$ 49,383
Broadcast cash flow margin(5)	43.3%	41.7%	45.4%	46.9%	44.9%
EBITDA(4)	\$ 20,884	\$ 22,076	\$ 27,970	\$ 28,763	\$ 31,979
After-tax cash flow(4)	\$ 11,594	\$ 10,647	\$ 12,335	\$ 15,809	\$ 19,035
Cash flows related to:					
Operating activities	\$ 10,495	\$ 7,314	\$ 11,015	\$ 8,204	\$ 10,712
Investing activities	\$ (18,923)	\$ (26,326)	\$ (31,762)	\$ (35,159)	\$ (219,848)
Financing activities	\$ 9,383	\$ 18,695	\$ 21,019	\$ 59,162	\$ 178,940

## December 31,

	1996	1997	1998	1999	2000
Balance Sheet Data:					
Cash and cash equivalents	\$ 1,962	\$ 1,645	\$ 1,917	\$ 34,124	\$ 3,928
Total assets	159,185	184,813	207,750	264,364	470,668
Long-term debt, less current portion	121,790	154,500	178,610	100,087	286,050
Stockholders' equity	20,354	10,682	9,101	142,839	152,948

- (1) Tax reimbursements to S corporation shareholders represent the income tax liabilities of our principal stockholders created by the income of New Inspiration and Golden Gate, which were both S corporations prior to our August 1997 reorganization. Pro forma net income (loss) excludes tax reimbursements to S corporation shareholders and includes a pro forma tax provision at an estimated combined federal and state income tax rate of 40% as if the reorganization had occurred at the beginning of each period presented. In August 1997, New Inspiration and Golden Gate became wholly-owned subsidiaries of Salem. From this date, pretax income of New Inspiration and Golden Gate is included in our computation of the income tax provision included in our consolidated statements of operations.

The following table reflects the pro forma adjustments to historical net income for the periods prior to and including our August 1997 reorganization:

	1996	1997
Pro Forma Information:		
Income (loss) before income taxes and extraordinary item as reported above	\$ 19,408	\$ (1,087)
Add back tax reimbursements to S corporation shareholders	2,038	1,780
Pro forma income (loss) before income taxes and extraordinary item	21,446	693
Pro forma provision (benefit) for income taxes	8,608	278
Pro forma income (loss) before extraordinary item	12,838	415
Extraordinary loss	—	(1,185)
Pro forma net income (loss)	\$ 12,838	\$ (770)

- (2) The extraordinary loss in each of 1997, 1999 and 2000 relates to the write-off of deferred financing costs and termination fees related to the repayment of debt. See note 5 to our consolidated financial statements.
- (3) See note 1 to our consolidated financial statements.
- (4) We define broadcast cash flow as net operating income, excluding other media revenue and other media operating expenses, before depreciation and amortization and corporate expenses. We define EBITDA as net operating income before depreciation and amortization. We define after-tax cash flow as income (loss) before extraordinary item minus gain (loss) on disposal of assets (net of income tax) plus depreciation and amortization. EBITDA and after-tax cash flow for the year ended December 31, 1999 excludes a \$2.6 million charge (\$1.9 million, net of income tax) for a one-time stock grant concurrent with our initial public offering. For periods prior to 1998, broadcast cash flow and EBITDA are calculated using net operating income before tax reimbursements to S corporation shareholders. For periods prior to 1998, after-tax cash flow excludes reimbursements to S corporation shareholders and includes a pro forma tax provision at an estimated combined federal and state income tax rate of 40% as if the reorganization had occurred at the beginning of each period presented.

Although broadcast cash flow, EBITDA and after-tax cash flow are not measures of performance calculated in accordance with generally accepted accounting principles, we believe that they are useful because they are measures widely used in the radio broadcast industry to evaluate a radio company's operating performance. However, you should not consider broadcast cash flow, EBITDA and after-tax cash flow in isolation or as substitutes for net income, cash flows from operating activities and other statement of operations or cash flows data prepared in accordance with generally accepted accounting principles as a measure of liquidity or profitability. These measures are not necessarily comparable to similarly titled measures employed by other companies.

- (5) Broadcast cash flow margin is broadcast cash flow as a percentage of net broadcasting revenue.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### GENERAL

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report. Our consolidated financial statements are not directly comparable from period to period because of our acquisition and disposition of radio stations and our acquisition of other media businesses. See note 2 to our consolidated financial statements.

Historically, the principal sources of our revenue have been:

- the sale of block program time, both to national and local program producers,
- the sale of advertising time on our radio stations, both to national and local advertisers, and
- the sale of advertising time on our national radio network.

In 1999, we expanded our sources of revenue and product offerings with the acquisition of other media businesses.

The following table shows gross broadcasting revenue, the percentage of gross broadcasting revenue for each broadcasting revenue source and net broadcasting revenue.

	Year Ended December 31,					
	1998		1999		2000	
	(Dollars in Thousands)					
Block program time:						
National	\$ 29,506	34.5%	\$ 31,317	32.9%	\$ 34,887	29.0%
Local	13,389	15.7	15,816	16.6	19,044	15.9
	42,895	50.2	47,133	49.5	53,931	44.9
Advertising:						
National	4,458	5.2	5,855	6.1	7,714	6.4
Local	26,106	30.6	29,686	31.2	40,905	34.1
	30,564	35.8	35,541	37.3	48,619	40.5
Infomercials	4,121	4.8	3,764	4.0	5,228	4.4
Salem Radio Network	6,053	7.1	6,983	7.3	9,174	7.6
Other	1,778	2.1	1,856	1.9	3,171	2.6
Gross broadcasting revenue	85,411	100.0%	95,277	100.0%	120,123	100.0%
Less agency commissions	7,520		8,155		10,026	
Net broadcasting revenue	\$ 77,891		\$ 87,122		\$ 110,097	

Our broadcasting revenue is affected primarily by the program rates our radio stations charge and by the advertising rates our radio stations and network charge. The rates for block program time are based upon our stations' ability to attract audiences that will support the program producers through contributions and purchases of their products. Advertising rates are based upon the demand for advertising time, which in turn is based on our stations' and network's ability to produce results for its advertisers. Historically we have not subscribed to traditional audience measuring services. Instead, we have marketed ourselves to advertisers based upon the responsiveness of our audience. With the launch of the contemporary Christian music format in several markets, we have started to subscribe to Arbitron which develops quarterly reports to measure a radio station's audience share in the demographic groups targeted by advertisers. See "Business - Radio Stations." Each of our radio stations and our network have a general pre-determined level of time that they make available for block programs and/or advertising, which may vary at different times of the day.

In recent years, we have begun to place greater emphasis on the development of local advertising in all of our markets. We encourage general managers and sales managers to increase advertising revenue. We can create additional advertising revenue in a variety of ways, such as removing block programming that generates marginal audience response, adjusting the start time of programs to add

advertising in more desirable time slots and increasing advertising rates.

As is typical in the radio broadcasting industry, our second and fourth quarter advertising revenue generally exceeds our first and third quarter advertising revenue. Quarterly revenue from the sale of block program time does not tend to vary, however, since program rates are generally set annually.

Our cash flow is affected by a transition period experienced by radio stations when, due to the nature of the radio station, our plans for the market and other circumstances, we find it beneficial or advisable to change its format. This transition period is when we develop a radio station's customer and listener base. During this period, a station will typically generate negative or insignificant cash flow.

In the broadcasting industry, radio stations often utilize trade or barter agreements to exchange advertising time for goods or services (such as other media advertising, travel or lodging), in lieu of cash. In order to preserve the sale of our advertising time for cash, we generally enter into trade agreements only if the goods or services bartered to us will be used in our business. We have minimized our use of trade agreements and have generally sold most of our advertising time for cash. In 2000, we sold 94% of our advertising time for cash. In addition, it is our general policy not to preempt advertising paid for in cash with advertising paid for in trade.



The primary operating expenses incurred in the ownership and operation of our radio stations include employee salaries and commissions, and facility expenses (for example, rent and utilities). Beginning in 2000, in connection with the launch of our contemporary Christian music format in several markets, we incurred increased amounts for promotional expenses and music license fees. In addition to these expenses, our network incurs programming costs and lease expenses for satellite communication facilities. We also incur and will continue to incur significant depreciation, amortization and interest expense as a result of completed and future acquisitions of radio stations and existing and future borrowings.

OnePlace earns its revenue from the (1) sales of banner advertising and sponsorships on the Internet, (2) sales of streaming services, and (3) sales of software and software support contracts. CCM earns its revenue by selling advertising in and subscriptions to its publications. The revenue and related operating expenses of these businesses are reported as "other media" on our condensed consolidated statements of operations.

The performance of a radio broadcasting company, such as Salem, is customarily measured by the ability of its stations to generate broadcast cash flow and EBITDA. We define broadcast cash flow as net operating income, excluding other media revenue and other media operating expenses, before depreciation and amortization and corporate expenses. We define EBITDA as net operating income before depreciation and amortization. We define after-tax cash flow as income (loss) before extraordinary item minus gain (loss) on disposal of assets (net of income tax) plus depreciation and amortization. EBITDA and after-tax cash flow for the year ended December 31, 1999 excludes a \$2.6 million charge (\$1.9 million, net of income tax) for a one-time stock grant concurrent with our initial public offering on June 30, 1999.

Although broadcast cash flow, EBITDA and after-tax cash flow are not measures of performance calculated in accordance with generally accepted accounting principles, and should be viewed as a supplement to and not a substitute for our results of operations presented on the basis of generally accepted accounting principles, we believe that broadcast cash flow, EBITDA and after-tax cash flow are useful because they are generally recognized by the radio broadcasting industry as measures of performance and are used by analysts who report on the performance of broadcast companies. These measures are not necessarily comparable to similarly titled measures employed by other companies.

In the following discussion of our results of operations, we compare our results between periods on an as reported basis (that is, the results of operations of all radio stations and network formats owned or operated at any time during either period) and on a "same station" basis.

For the comparison of the results of operations for the year ended December 31, 1999 to the year ended December 31, 1998, we included in our same station comparisons the results of operations of radio stations and network formats that:

- we owned or operated for all of both periods;
- we acquired or began to operate at any time after the beginning of the first relevant comparison period if the station or network format (i) was in a market in which we already owned or operated a radio station or network format and (ii) was integrated with the existing station or network format for our internal financial reporting purposes; or

- we sold or ceased to operate at any time after the beginning of the first relevant comparison period if the station or network format (i) was integrated with another station or network format in a market for our internal financial reporting purposes prior to the sale or cessation of operations and (ii) we continued to own or operate the other station or network format following the sale or cessation of operations.

We included in our same station comparisons the results of operations of our integrated stations and network formats from the date that we acquired or began to operate them or through the date that we sold or ceased to operate them, as the case may be.

For the comparison of the results of operations for the year ended December 31, 2000 to the year ended December 31, 1999, we include in our same station comparisons the results of operations of radio stations and networks that we own or operate in the same format during the current period compared with the results of the same stations for the corresponding period of the prior year. We do not include a station or a network in this comparison unless it has been owned or operated for at least an entire quarter included in each of the current and corresponding prior year periods.

#### RESULTS OF OPERATIONS

##### **YEAR ENDED DECEMBER 31, 2000**

##### **COMPARED TO YEAR ENDED DECEMBER 31, 1999**

**NET BROADCASTING REVENUE.** Net broadcasting revenue increased \$23.0 million or 26.4% to \$110.1 million in 2000 from \$87.1 million in 1999. The growth is attributable to the increase in same station revenue and the acquisitions of radio stations and a network during 1999 and 2000, partially offset by the sales of radio stations during 2000. On a same station basis net revenue improved \$8.1 million or 12.5% to \$72.7 million in 2000 from \$64.6 million in 1999. The improvement was primarily due to an increase in network revenue due to increased network affiliations and quality programming, an increase in net revenue at radio stations we acquired in 1997 and 1998 that previously operated with formats other than their current format, an increase in program rates and increases in advertising time and improved selling efforts at both the national and local level. Revenue from advertising as a percentage of our gross revenue increased to 40.5% in 2000 from 37.3% in 1999. Revenue from block program time as a percentage of our gross revenue decreased to 44.9% in 2000 from 49.5% in 1999. This change in our revenue mix is primarily due to our continued efforts to develop more local advertising sales in all of our markets, as well as the acquisition and launch of a number of news/talk and contemporary Christian music formatted stations that do not carry block programming.

**OTHER MEDIA REVENUE.** Other media revenue increased \$1.5 million or 23.4% to \$7.9 million in 2000 from \$6.4 million in 1999. The increase is due primarily to our increased revenue from banner advertising and streaming services and the inclusion of revenues from the acquisition of the Involved Christian Radio Network, which we acquired in November 1999, offset by the loss of revenues from the sale of certain assets which generated revenue from the sale of advertising in print and online catalogs.

**BROADCASTING OPERATING EXPENSES.** Broadcasting operating expenses increased \$14.4 million or 31.1% to \$60.7 million in 2000 from \$46.3 million in 1999. The increase is attributable to operating expenses associated with the acquisitions of radio stations and a network in 2000, promotional expenses associated with the launch of the contemporary Christian music format in several markets, and an increase in bad debt expense and an increase in music license

fees, partially offset by the operating expenses associated with three radio stations sold during 2000. On a same station basis, broadcasting operating expenses increased \$3.5 million or 10.1% to \$38.3 million in 2000 from \$34.8 million in 1999. The increase is primarily due to incremental selling and production expenses incurred to produce the increased revenue in the period.

**OTHER MEDIA OPERATING EXPENSES.** Other media operating expenses increased \$4.9 million or 49.0% to \$14.9 million in 2000 from \$10.0 million in 1999. The increase is due primarily to product fulfillment costs associated with e-commerce which closed down in 2000, additional streaming and related expenses to produce the increased revenues in 2000, the inclusion of operating expenses from the acquisition of the Involved Christian Radio Network, which we acquired in November 1999, offset by the reduction of operating expenses incurred due to the sale of certain software products, assets and contracts.

**BROADCAST CASH FLOW.** Broadcast cash flow increased \$8.6 million or 21.1% to \$49.4 million in 2000 from \$40.8 million in 1999. As a percentage of net broadcasting revenue, broadcast cash flow decreased to 44.9% in 2000 from 46.8% in 1999. The decrease is primarily attributable to the effect of stations acquired during 1999 and 2000 that previously operated with formats other than their current format and the effect of the launch of the contemporary Christian music format in several markets. Acquired and reformatted radio stations typically produce low margins during the first few years following conversion. Broadcast cash flow margins improve as we implement scheduled program rate increases and increase advertising revenue on our stations. On a same station basis, broadcast cash flow improved \$4.6 million or 15.4% to \$34.4 million in 2000 from \$29.8 million in 1999.

**CORPORATE EXPENSES.** Corporate expenses increased \$2.0 million or 23.5% to \$10.5 million in 2000 from \$8.5 million in 1999, primarily due to additional overhead costs associated with radio station and other media acquisitions in 1999 and 2000 and increased public reporting and related costs, offset by a reduction of expenses of \$400,000 in 2000 due to the termination of a deferred compensation agreement.

**EBITDA.** EBITDA increased \$3.2 million or 11.1% to \$32.0 million in 2000 from \$28.8 million in 1999. As a percentage of total revenue, EBITDA decreased to 27.1% in 2000 from 30.8% in 1999. EBITDA was negatively impacted by the results of operations of our other media businesses acquired during 1999, which generated a net loss before depreciation and amortization of \$7.0 million in 2000 as compared to a net loss of \$3.6 million in 1999. EBITDA excluding the other media businesses increased \$6.7 million or 20.7% to \$39.0 million in 2000 from \$32.3 million in 1999. As a percentage of net broadcasting revenue, EBITDA excluding the other media businesses decreased to 35.4% in 2000 from 37.1% in 1999. The decrease is primarily attributable to the effect of stations acquired during 1999 and 2000 that previously operated with formats other than their current format and the effect of the launch of the contemporary Christian music format in several markets.

**DEPRECIATION AND AMORTIZATION.** Depreciation expense increased \$0.5 million or 7.6% to \$7.1 million in 2000 from \$6.6 million in 1999. Amortization expense increased \$6.8 million or 58.6% to \$18.4 million in 2000 from \$11.6 million in 1999. The increases are due to radio station and other media acquisitions consummated during 2000 and 1999.

**OTHER INCOME (EXPENSE).** Interest income decreased \$500,000 to \$500,000 in 2000 from \$1.0 million in 1999. The decrease is primarily due to a decrease in excess cash available for investment due to acquisitions of radio stations and other media businesses. Gain on disposal of assets of \$29.6 million in 2000 is primarily due to gains recognized on the sale of radio stations KPRZ-FM, Colorado Springs, CO and KLTX-AM, Los Angeles, CA, partially offset by the loss on sale of certain assets of our other media businesses. Interest expense increased \$3.3 million or 23.2% to \$17.5 million in 2000 from \$14.2 million in 1999. The increase is due to interest expense associated with borrowings on our credit facility and higher interest expense associated with short-term bridge financing to fund acquisitions in 2000. Other expense increased \$224,000 to \$857,000 in 2000 from \$633,000 in 1998 primarily due to increased bank commitment fees.

**PROVISION (BENEFIT) FOR INCOME TAXES.** Provision (benefit) for income taxes as a percentage of income (loss) before income taxes and extraordinary item (that is, the effective tax rate) was 38.3% for 2000 and (26.5%) for 1999. The effective tax rate in 2000 and 1999 differs from the federal statutory income tax rate of 35.0% primarily due to the effect of state income taxes and certain expenses that are not deductible for tax purposes.

**NET INCOME (LOSS).** We recognized net income of \$10.1 million in 2000, compared to a net loss of \$8.0 million in 1999. Included in the net income for 2000 is a gain in the disposal of assets of \$29.6 million and a \$1.2 million extraordinary loss, net of income tax benefit, resulting from the write-off of deferred financing costs related to our short-term bridge financing.

**AFTER-TAX CASH FLOW.** After-tax cash flow increased \$3.2 million or 20.3% to \$19.0 million in 2000 from \$15.8 million in 1999. This increase was offset by negative after-tax cash flow of our other media businesses. After-tax cash flow excluding other media losses (net of income tax) increased \$5.3 million or 29.6% to \$23.2 million in 2000 from \$17.9 million in 1999. The increase is primarily due to an increase in broadcast cash flow, offset by an increase in interest expense.

#### **YEAR ENDED DECEMBER 31, 1999 COMPARED TO YEAR ENDED DECEMBER 31, 1998**

**NET BROADCASTING REVENUE.** Net broadcasting revenue increased \$9.2 million or 11.8% to \$87.1 million in 1999 from \$77.9 million in 1998. The inclusion of revenue from the acquisitions of radio stations and revenue generated from local marketing agreements entered into during 1999 and 1998, partially offset by the loss of revenue from radio stations sold in 1998, provided \$1.9 million of the increase. On a same station basis, net revenue improved \$7.3 million or 9.6% to \$83.1 million in 1999 from \$75.8 million in 1998. Included in the same station comparison are the results of two stations that we began to own or operate in 1999 for a total purchase price of \$1.8 million, and three stations that we acquired in 1998 for a total purchase price of \$3.1 million. The improvement was primarily due to an increase in revenue at the radio stations we acquired in 1997 that previously operated with formats other than their current format, an increase in program rates and an increase in advertising time and improved selling efforts at both the national and local level. Revenue from advertising as a percentage of our gross revenue increased to 37.3% in 1999 from 35.8% in 1998. Revenue from block program time as a percentage of our gross revenue decreased to 49.5% in 1999 from 50.2% in 1998. This change in our revenue mix is primarily due to our continued efforts to develop more local advertising sales in all of our markets.

**OTHER MEDIA REVENUE.** Other media revenue was \$6.4 million for the year ended December 31, 1999 and was generated from businesses acquired in 1999.

**BROADCASTING OPERATING EXPENSES.** Broadcasting operating expenses increased \$3.8 million or 8.9% to \$46.3 million in 1999 from \$42.5 million in 1998. The inclusion of expenses from the acquisitions of radio stations and expenses incurred for local marketing agreements entered into during 1999 and 1998, partially offset by the exclusion of operating expenses from radio stations sold in 1998, accounted for \$1.4 million of the increase. On a same station basis, broadcasting operating expenses increased \$2.4 million or 5.8% to \$43.9 million in 1999 from \$41.5 million in 1998, primarily due to incremental selling and production expenses incurred to produce the increased revenue in the period. The difference between 1999 and 1998 broadcasting operating expenses was increased by a one-time credit of \$453,000 that we recorded in 1998. The credit related to music licensing fees and represented the proceeds of a settlement between us and the two largest performance rights organizations.

**OTHER MEDIA OPERATING EXPENSES.** Other media operating expenses were \$10.0 million for the year ended December 31, 1999 and were incurred in the businesses acquired in 1999.

**BROADCAST CASH FLOW.** Broadcast cash flow increased \$5.4 million or 15.3% to \$40.8 million in 1999 from \$35.4 million in 1998. As a percentage of net broadcasting revenue, broadcast cash flow increased to 46.8% in 1999 from 45.4% in 1998. The increase is primarily attributable to the improved performance of radio stations acquired in 1997 and 1998 that previously operated with formats other than their current format, offset by a one-time credit for music licensing fees in 1998. Acquired and reformatted radio stations typically produce low margins during the first few years following conversion. Broadcast cash flow margins improve as we implement scheduled program rate increases and increase advertising revenue on our stations. On a same station basis, broadcast cash flow improved \$4.9 million or 14.3% to \$39.2 million in 1999 from \$34.3 million in 1998.

**CORPORATE EXPENSES.** Corporate expenses increased \$1.1 million or 14.9% to \$8.5 million in 1999 from \$7.4 million in 1998, primarily due to an increase in bonuses of \$300,000 in 1999 as compared to 1998, an increase in executive officer compensation of \$340,000 as compared to 1998, public reporting costs of \$200,000 and additional personnel and overhead costs associated with radio station and other media acquisitions in 1999.

**EBITDA.** EBITDA increased \$800,000 or 2.9% to \$28.8 million in 1999 from \$28.0 million in 1998. As a percentage of total revenue, EBITDA decreased to 30.8% in 1999 from 35.9% in 1998. EBITDA was negatively impacted by the results of operations of our other media businesses acquired during 1999, which generated a net loss before depreciation and amortization of \$3.6 million during the year. EBITDA excluding the other media businesses increased \$4.3 million or 15.4% to \$32.3 million in 1999 from \$28.0 million in 1998. As a percentage of net broadcasting revenue, EBITDA excluding the other media businesses increased to 37.1% in 1999 from 35.9% in 1998. The increase is primarily attributable to the improved performance of radio stations acquired in 1997 and 1998 that previously operated with formats other than their current format.

**DEPRECIATION AND AMORTIZATION.** Depreciation expense increased \$2.3 million or 53.5% to \$6.6 million in 1999 from \$4.3 million in 1998. Amortization expense increased \$1.8 million or 18.4% to \$11.6 million in 1999 from \$9.8 million in 1998. The increases were

primarily due to radio station and other media acquisitions consummated during 1999 and 1998.

**OTHER INCOME (EXPENSE).** Interest income increased \$700,000 to \$1.0 million in 1999 from \$300,000 in 1998. The increase is primarily due to the interest earned on the investment of the net proceeds received on our initial public offering in July 1999. Interest expense decreased \$1.7 million or 10.7% to \$14.2 million in 1999 from \$15.9 million in 1998. The decrease is primarily due to interest expense associated with \$50 million in principal amount of the senior subordinated notes repurchased in July 1999 partially offset by interest expense associated with additional borrowings to fund acquisitions consummated during 1998 and the first and second quarters of 1999. Other expense increased \$211,000 to \$633,000 in 1999 from \$422,000 in 1998 primarily due to increased bank commitment fees.

**PROVISION (BENEFIT) FOR INCOME TAXES.** Provision (benefit) for income taxes as a percentage of income (loss) before income taxes and extraordinary item (that is, the effective tax rate) was (26.5)% for 1999 and (17.8)% for 1998. The effective tax rate in 1999 and 1998 differs from the federal statutory income tax rate of 34.0% primarily due to the effect of state income taxes and certain expenses that are not deductible for tax purposes.

**NET INCOME (LOSS).** We recognized a net loss of \$8.0 million in 1999, compared to a net loss of \$1.6 million in 1998. Included in the net loss for 1999 is a \$3.6 million extraordinary loss, net of income tax benefit, resulting from the premium paid on the repurchase of \$50 million principal amount of our senior subordinated notes, the related write-off of a portion of the unamortized bond issue costs, and the write-off of deferred financing costs related to our credit facility. Additionally, we incurred a \$1.9 million charge, net of income tax, related to a one-time stock grant concurrent with our initial public offering on June 30, 1999.

**AFTER-TAX CASH FLOW.** After-tax cash flow increased \$3.5 million or 28.5% to \$15.8 million in 1999 from \$12.3 million in 1998. This increase was offset by negative after-tax cash flow of our other media businesses in 1999. After-tax cash flow excluding other media losses (net of income tax) increased \$5.6 million or 45.5% to \$17.9 million from \$12.3 million in 1998. The increase is primarily due to an increase in broadcast cash flow and a decrease in interest expense.

## LIQUIDITY AND CAPITAL RESOURCES

We have historically financed acquisitions of radio stations through borrowings, including borrowings under bank credit facilities and, to a lesser extent, from operating cash flow and selected asset dispositions. We received net proceeds of \$140.1 million from our initial public offering in July 1999, which was used to pay a portion of our senior subordinated notes and amounts outstanding under our credit facility. We have historically funded, and will continue to fund, expenditures for operations, administrative expenses, capital expenditures and debt service required by our credit facility and senior subordinated notes from operating cash flow. At December 31, 2000 we had \$3.9 million of cash and cash equivalents and positive working capital of \$20.0 million.

We will fund future acquisitions from cash on hand, borrowings under our amended credit facility, sales of existing radio stations and operating cash flow. We believe that cash on hand, cash flow from operations, borrowings under our amended credit facility, and proceeds from the sale of some of our existing radio stations will be sufficient to permit us to meet our financial obligations, fund our pend-

ing acquisitions and fund operations for at least the next twelve months.

In August 2000, we amended our credit facility and obtained a bridge loan facility principally to finance the acquisition of eight radio stations on August 24, 2000. To finance the acquisitions we borrowed \$109.1 million under the amended credit facility and \$58.0 million under the bridge loan facility with \$7.1 million of the bridge loan proceeds used to fund a 12-month interest reserve.

In August 2000, we supplemented the indenture for our senior subordinated notes in connection with the assignment of substantially all of the assets and liabilities of the company to HoldCo, including the obligations as successor issuer under the indenture.

In November 2000 we paid off the bridge facility using available cash, interest reserves and \$48.3 million borrowed under our credit facility. The bridge facility would otherwise have matured on August 23, 2001 had we not paid it off. Amounts outstanding under the bridge facility bore a floating interest rate of LIBOR plus a spread. The spread ranged from 5% to 6.5%. Interest was payable quarterly. As a result of the repayment of the bridge facility, we wrote-off certain deferred financing costs. The write-off of \$1,187,000, net of a \$662,000 income tax benefit, was recorded as an extraordinary item in the accompanying statement of operations for the year ended December 31, 2000.

At December 31, 2000, we had \$186.1 million outstanding under our credit facility. Our amended credit facility increased our borrowing capacity from \$150 million to \$225 million, lowered the borrowing rates and modified current financial ratio tests to provide us with additional borrowing flexibility. The amended credit facility matures on June 30, 2007. Aggregate commitments under the amended credit facility begin to decrease commencing March 31, 2002.

Amounts outstanding under our credit facility bear interest at a base rate, at our option, of the bank's prime rate or LIBOR, plus a spread. For purposes of determining the interest rate under our credit facility, the prime rate spread ranges from 0% to 1.5%, and the LIBOR spread ranges from 0.875% to 2.75%.

The maximum amount that we may borrow under our credit facility is limited by a ratio of our existing adjusted debt to pro forma twelve-month cash flow (the "Adjusted Debt to Cash Flow Ratio"). Our credit facility will allow us to adjust our total debt as used in such calculation by the lesser of 50% of the aggregate purchase price of acquisitions of newly acquired non-religious formatted radio stations that we reformat to a religious talk, conservative talk or religious music format or \$30.0 million and the cash flow from such stations will not be considered in the calculation of the ratio. The maximum Adjusted Debt to Cash Flow Ratio allowed under our credit facility is 6.50 to 1 through December 30, 2001. Thereafter, the maximum ratio will decline periodically until December 31, 2005, at which point it will remain at 4.00 to 1 through June 2007. The Adjusted Debt to Cash Flow Ratio at December 31, 2000 was 5.45 to 1, resulting in a borrowing availability of approximately \$39.0 million.

HoldCo is the borrower under the amended credit facility. HoldCo is a wholly-owned subsidiary of Salem and HoldCo is the direct or indirect parent of all operating subsidiaries with the exception of AcquisitionCo and SCA, both of which are direct or indirect subsidiaries of Salem.

Our credit facility contains additional restrictive covenants customary for credit facilities of the size, type and purpose contemplated which, with specified exceptions, limits our ability to enter into affiliate transactions, pay dividends, consolidate, merge or effect cer-

tain asset sales, make specified investments, acquisitions and loans and change the nature of our business. The credit facility also requires us to satisfy specified financial covenants, which covenants require the maintenance of specified financial ratios and compliance with certain financial tests, including ratios for maximum leverage as described, minimum interest coverage (not less than 1.75 to 1), minimum debt service coverage (a static ratio of not less than 1.1 to 1) and minimum fixed charge coverage (a static ratio of not less than 1.1 to 1). The amended credit facility is guaranteed by the company and all of its subsidiaries other than HoldCo and is secured by pledges of all of the capital stock of the company's subsidiaries.

In September 1997, we issued \$150 million principal amount of 9 1/2% senior subordinated notes due 2007. In July 1999, we repurchased \$50 million in principal amount of the senior subordinated notes with a portion of the net proceeds of the offering. After giving effect to this repurchase, we are required to pay \$9.5 million per year in interest on the senior subordinated notes. The indenture for the senior subordinated notes contains restrictive covenants that, among others, limit the incurrence of debt by us and our subsidiaries, the payment of dividends, the use of proceeds of specified asset sales and transactions with affiliates. The senior subordinated notes are guaranteed by all of our subsidiaries.

As a result of the repurchase of our senior subordinated notes in July 1999, we recorded a non-cash charge of \$1.5 million for the write-off of unamortized bond issue costs. This was in addition to the \$3.9 million premium paid in connection with this repurchase.

Net cash provided by operating activities increased to \$10.7 million for the year ended December 31, 2000, compared to \$8.2 million in 1999, primarily due to an increase in broadcast cash flow and an increase in accounts payable and accrued expenses, partially offset by an increase in accounts receivable and interest expense.

Net cash used in investing activities increased to \$219.8 million for the year ended December 31, 2000, compared to \$35.2 million in 1999 primarily due to acquisitions (cash used of \$234.9 million to purchase 26 radio stations and one network in 2000 compared to cash used of \$23.9 million to purchase three radio stations and other media businesses in 1999).

Net cash provided by financing activities increased to \$178.9 million for the year ended December 31, 2000 compared to \$59.2 million in 1999. The increase was primarily due to borrowings under our credit facility and short-term bridge financing.

Subsequent to December 31, 2000, we purchased the assets (principally intangibles) of the following radio stations:

Acquisition Date	Station	Market Served	Purchase Price
(in thousands)			
February 2, 2001	WXRT-AM	Chicago, IL	\$ 29,000
February 16, 2001	WWTC-AM	Minneapolis, MN	5,000
February 16, 2001	WZER-AM	Milwaukee, WI	2,100
March 9, 2001	WRBP-AM	Warren, OH	500
March 16, 2001	WFIA-AM	Louisville, KY	1,750
			<u>\$ 38,350</u>

On January 17, 2001, the company entered into an agreement to purchase the assets of radio station WROL-AM, Boston, MA, for 11 million. The company anticipates this transaction to close in the first half of 2001.

On January 22, 2001, the company sold the assets of radio station KALC-FM, Denver, CO for \$100 million.

**CONSOLIDATED BALANCE SHEETS***(In thousands, except share and per share data)*

	December 31,	
	1999	2000
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 34,124	\$ 3,928
Accounts receivable (less allowance for doubtful accounts of \$1,753 in 1999 and \$3,550 in 2000)	17,481	25,129
Other receivables	645	1,230
Prepaid expenses	1,628	1,558
Due from stockholders	905	450
Deferred income taxes	732	2,250
Total current assets	55,515	34,545
Property, plant, equipment and software, net	50,665	69,004
Intangible assets:		
Broadcast licenses	177,487	397,137
Noncompetition agreements	14,625	12,618
Customer lists and contracts	4,097	3,301
Favorable and assigned leases	1,800	1,800
Goodwill	15,177	16,739
Other intangible assets	4,799	4,899
	217,985	436,494
Less accumulated amortization	67,465	78,012
Intangible assets, net	150,520	358,482
Bond issue costs	2,750	2,396
Other assets	4,914	6,241
Total assets	\$ 264,364	\$ 470,668

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Current liabilities:		
Accounts payable	\$ 2,600	\$ 4,786
Accrued expenses	825	1,245
Accrued compensation and related	2,478	3,361
Accrued interest	2,546	3,299
Deferred subscription revenue	1,670	1,509
Income taxes	148	300
Current portion of long-term debt and capital lease obligations	3,248	93
Total current liabilities	13,515	14,593
Long-term debt, less current portion	100,087	286,050
Deferred income taxes	7,232	15,279
Other liabilities	691	1,798
Stockholders' equity:		
Class A common stock, \$.01 par value; authorized 80,000,000 shares; issued and outstanding 17,902,392 shares	179	179
Class B common stock, \$.01 par value; authorized 20,000,000 shares; issued and outstanding 5,553,696 shares	56	56
Additional paid-in capital	147,380	147,380
Retained earnings (deficit)	(4,776)	5,333
Total stockholders' equity	142,839	152,948
Total liabilities and stockholders' equity	\$ 264,364	\$ 470,668

See accompanying notes.

# CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)

	Year Ended December 31,		
	1998	1999	2000
Gross broadcasting revenue	\$ 85,411	\$ 95,277	\$ 120,123
Less agency commissions	7,520	8,155	10,026
Net broadcasting revenue	77,891	87,122	110,097
Other media revenue	—	6,424	7,916
Total revenue	77,891	93,546	118,013
Operating expenses:			
Broadcasting operating expenses	42,526	46,291	60,714
Other media operating expenses	—	9,985	14,863
Corporate expenses	7,395	8,507	10,457
Stock and related cash grant	—	2,550	—
Depreciation (including \$1,817 in 1999 and \$1,344 in 2000 for other media businesses)	4,305	6,599	7,087
Amortization (including \$420 in 1999 and \$1,146 in 2000 for other media businesses)	9,753	11,634	18,392
Total operating expenses	63,979	85,566	111,513
Net operating income	13,912	7,980	6,500
Other income (expense):			
Interest income	291	1,005	534
Gain (loss) on sale of assets	236	(219)	773
Gain on sale of assets to related party	—	—	28,794
Interest expense	(15,941)	(14,219)	(17,452)
Other expense	(422)	(633)	(857)
Income (loss) before income taxes and extraordinary item	(1,924)	(6,086)	18,292
Provision (benefit) for income taxes	(343)	(1,611)	6,996
Income (loss) before extraordinary item	(1,581)	(4,475)	11,296
Extraordinary loss on early extinguishment of debt (net of income tax benefit of \$1,986 in 1999 and \$662 in 2000)	—	(3,570)	(1,187)
Net income (loss)	\$ (1,581)	\$ (8,045)	\$ 10,109
Basic and diluted earnings (loss) per share before extraordinary item	\$ (0.09)	\$ (0.22)	\$ 0.48
Extraordinary loss per share	—	(0.18)	(0.05)
Basic and diluted net earnings (loss) per share	\$ (0.09)	\$ (0.40)	\$ 0.43
Basic weighted average shares outstanding	16,661,088	20,066,006	23,456,088
Diluted weighted average shares outstanding	16,661,088	20,066,006	23,466,849

See accompanying notes.

# CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except share data)

	Class A Common Stock		Class B Common Stock		Additional Paid-In Capital	Retained Earnings/ (Deficit)	Total
	Shares	Amount	Shares	Amount			
Stockholders' equity, January 1, 1998	11,107,392	\$ 111	5,553,696	\$ 56	\$ 5,665	\$ 4,850	\$ 10,682
Net loss	—	—	—	—	—	(1,581)	(1,581)
Stockholders' equity, December 31, 1998	11,107,392	111	5,553,696	56	5,665	3,269	9,101
Stock grant	75,000	1	—	—	1,687	—	1,688
Issuance of Class A common stock	6,720,000	67	—	—	140,028	—	140,095
Net loss	—	—	—	—	—	(8,045)	(8,045)
Stockholders' equity, December 31, 1999	17,902,392	179	5,553,696	56	147,380	(4,776)	142,839
Net income	—	—	—	—	—	10,109	10,109
<b>Stockholders' equity, December 31, 2000</b>	<b>17,902,392</b>	<b>\$ 179</b>	<b>5,553,696</b>	<b>\$ 56</b>	<b>\$ 147,380</b>	<b>\$ 5,333</b>	<b>\$ 152,948</b>

See accompanying notes.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended December 31,		
	1998	1999	2000
<b>Operating Activities</b>			
Net income (loss)	\$ (1,581)	\$ (8,045)	\$ 10,109
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	14,058	18,233	25,479
Amortization of bank loan fees	42	87	678
Amortization of bond issue costs	531	443	354
Deferred income taxes	(730)	(4,106)	5,790
(Gain) loss on sale of assets	(236)	219	(29,567)
Loss on early extinguishment of debt, before taxes	—	5,556	1,849
Noncash stock grant	—	1,688	—
Changes in operating assets and liabilities:			
Accounts receivable	(2,048)	(2,573)	(8,632)
Prepaid expenses and other current assets	(18)	(1,747)	422
Accounts payable and accrued expenses	1,035	(1,555)	4,224
Deferred subscription revenue	—	384	(161)
Other liabilities	166	(439)	15
Income taxes	(204)	59	152
Net cash provided by operating activities	11,015	8,204	10,712
<b>Investing Activities</b>			
Purchases of property, plant, equipment and software	(6,865)	(9,142)	(14,804)
Deposits on radio station acquisitions	4,907	(1,325)	(512)
Purchases of radio stations	(33,682)	(11,837)	(234,853)
Purchases of other media businesses	—	(12,049)	—
Proceeds from sale of property, plant and equipment and intangible assets	4,226	73	30,080
Expenditures for tower construction project held for sale	(495)	(410)	—
Proceeds from sale of tower construction project	—	914	—
Other assets	147	(1,383)	241
Net cash used in investing activities	(31,762)	(35,159)	(219,848)
<b>Financing Activities</b>			
Proceeds from issuance of long-term debt and notes payable to stockholders	40,500	18,750	204,050
Proceeds from issuance of bridge financing	—	—	58,000
Net proceeds from issuance of common stock	—	140,095	—
Payments of long-term debt and notes payable to stockholders	(19,200)	(94,860)	(20,810)
Payments of bridge financing	—	—	(58,000)
Payments on capital lease obligations	—	(239)	(250)
Payment of premium on senior subordinated notes	—	(3,875)	—
Payments of costs related to bank credit facility and bridge financing	—	(709)	(4,050)
Payments of bond issue costs	(281)	—	—
Net cash provided by financing activities	21,019	59,162	178,940
Net (decrease) increase in cash and cash equivalents	272	32,207	(30,196)
Cash and cash equivalents at beginning of year	1,645	1,917	34,124
Cash and cash equivalents at end of year	\$ 1,917	\$ 34,124	\$ 3,928
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the year for:			
Interest	\$ 14,965	\$ 15,048	\$ 15,831
Income taxes	591	450	390
<b>Non-cash investing activities</b>			
Fair value of assets exchanged involving boot, excluding amount paid in cash	—	—	\$ 5,500
No other exchange transactions had an impact on the carrying amount of the assets			

See accompanying notes.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation and Reorganization

The accompanying consolidated financial statements of Salem Communications Corporation ("Salem" or the "Company") include the Company and its wholly-owned subsidiaries. All significant inter-company balances and transactions have been eliminated.

The Company is a holding company with substantially no assets, operations or cash flows other than its investments in subsidiaries. In May 2000, the Company formed two new wholly-owned subsidiaries, Salem Communications Holding Corporation ("HoldCo") and Salem Communications Acquisition Corporation ("AcquisitionCo"), each a Delaware corporation. In July 2000, the Company formed SCA License Corporation ("SCA"), a Delaware corporation. HoldCo and AcquisitionCo are direct subsidiaries of the Company; SCA is a wholly-owned subsidiary of AcquisitionCo. HoldCo and all of its subsidiaries are Guarantors of the 9 <sup>1</sup>/<sub>2</sub>% Senior Subordinated Notes due 2007 (the "Notes") discussed in Note 5. The Guarantors (i) are wholly-owned subsidiaries of the HoldCo, (ii) comprise substantially all the HoldCo's direct and indirect subsidiaries and (iii) have fully and unconditionally guaranteed on a joint and several basis, the Notes. AcquisitionCo and SCA are not guarantors of the 9 <sup>1</sup>/<sub>2</sub>% Senior Subordinated Notes due 2007. SCA owns the assets of KALC-FM.

#### Description of Business

Salem is a domestic U.S. radio broadcast company which has traditionally provided talk and music programming targeted at audiences interested in religious and family issues. Salem operated 71 and 54 radio stations across the United States at December 31, 2000 and 1999, respectively. The Company also owns and operates Salem Radio Network ("SRN"), SRN News Network ("SNN"), Salem Music Network ("SMN"), Reach Satellite Network ("RSN") and Salem Radio Representatives ("SRR"). SRN, SNN, SMN and RSN are radio networks which produce and distribute talk, news and music programming to radio stations in the U.S., including some of Salem's stations. SRR sells commercial air time to national advertisers for Salem's radio stations and networks, and for independent radio station affiliates.

Salem also owns and operates OnePlace, LLC ("OnePlace") and CCM Communications, Inc. ("CCM"). OnePlace provides on-demand audio streaming and related services. CCM publishes magazines that follow the Christian music industry. The revenue and related operating expenses of these businesses are reported as "other media" on the consolidated statements of operations.

#### Segments

The Company has adopted the provisions of Financial Accounting Standards Board Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information." The Company identifies its operating segments based on business activities. The Company's chief operating decision maker reviews financial information to manage the business consistent with the manner presented in the consolidated financial statements. As the Company acquires and integrates new businesses it evaluates, based on the nature, size and

integration and management strategies, whether it has separate reportable segments. During the three years ended December 31, 2000, the Company had one reportable segment.

#### Revenue Recognition

Revenues are recognized when pervasive evidence of an arrangement exists, delivery has occurred or the service has been rendered, the price to the customer is fixed or determinable and collection of the arrangement fee is reasonably assured.

Revenue from radio programs and commercial advertising is recognized when broadcast. Salem's broadcasting customers principally include not-for-profit charitable organizations and commercial advertisers.

Revenue from the sale of products and services from the Company's other media businesses is recognized when the products are shipped and the services are rendered. Revenue from the sale of advertising in CCM's publications is recognized upon publication. Revenue from the sale of subscriptions to CCM's publications is recognized over the life of the subscription.

Advertising by the radio stations exchanged for goods and services is recorded as the advertising is broadcast and is valued at the estimated value of goods or services received or to be received. The value of the goods and services received in such barter transactions is charged to expense when used. The estimated fair value of the barter advertising provided for the years ended December 31, 1998, 1999 and 2000, was approximately \$2,510,000, \$2,936,000 and \$3,053,000, respectively. Barter expenses were approximately the same. Barter advertising provided and barter expenses incurred are included net in broadcasting operating expenses.

#### Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards requiring that all derivatives be recorded in the balance sheet as either an asset or liability measured at fair value and that changes in fair value be recognized currently in earnings, unless specific hedge accounting criteria are met. Certain provisions of SFAS No. 133, including its required implementation date, were subsequently amended. The Company will adopt SFAS No. 133, as amended, in the first quarter of 2001 and its adoption will not have a material effect on the Company's results of operations or financial position.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements." SAB No. 101 provides guidance on applying generally accepted accounting principles to revenue recognition issues in financial statements. The Company adopted SAB No. 101 in the fourth quarter of 2000 and its adoption has not had a material effect on the Company's results of operations or financial position.

#### Cash Equivalents

Salem considers all highly liquid debt instruments with a maturity of three months or less when purchased to be cash equivalents. The recorded amount for cash and cash equivalents approximates the fair market value.

### Property, Plant, Equipment and Software

Property, plant, equipment and software are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over estimated useful lives as follows:

Buildings	40 years
Office furnishings and equipment	5-10 years
Antennae, towers and transmitting equipment	20 years
Studio and production equipment	10 years
Computer software	3-5 years
Record and tape libraries	20 years
Automobiles	5 years
Leasehold improvements	15 years

The carrying value of property, plant, equipment and software is evaluated periodically in relation to the operating performance and anticipated future cash flows of the underlying radio stations and businesses for indicators of impairment. When indicators of impairment are present and the undiscounted cash flows estimated to be generated from these assets are less than the carrying value of these assets an adjustment to reduce the carrying value to the fair market value of the assets is recorded, if necessary. No adjustments to the carrying amounts of property, plant, equipment and software have been made during the years ended December 31, 1998, 1999 and 2000.

### Intangible Assets

Intangible assets acquired in conjunction with the acquisition of various radio stations and other media businesses are being amortized over the following estimated useful lives using the straight-line method:

Broadcast licenses	10-25 years
Noncompetition agreements	3-5 years
Customer lists and contracts	10-15 years
Favorable and assigned leases	Life of the lease
Goodwill	15-40 years
Other	5-10 years

The carrying value of intangibles is evaluated periodically in relation to the operating performance and anticipated future cash flows of the underlying radio stations and businesses for indicators of impairment. When indicators of impairment are present and the undiscounted cash flows estimated to be generated from these assets are less than the carrying amounts of these assets, an adjustment to reduce the carrying value to the fair market value of these assets is recorded, if necessary. No adjustments to the carrying amounts of intangible assets have been made during the year ended December 31, 1998, 1999 and 2000.

### Bond Issue Costs

Bond issue costs are being amortized over the term of the Notes as an adjustment to interest expense.

### Accounting For Stock Based Compensation

Employee stock options are accounted for under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," which requires the recognition of expense when the option price is less than the fair value of the stock at the date of grant.

The Company generally awards options for a fixed number of shares at an option price equal to the fair value at the date of grant. The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" (see Note 8).

### Income Taxes

The Company accounts for income taxes in accordance with the liability method of providing for deferred income taxes. Deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements.

### Basic and Diluted Net Earnings (Loss) Per Share

Basic net earnings (loss) per share has been computed using the weighted average number of shares of common stock outstanding during the period. Diluted net earnings (loss) per share is computed using the weighted average number of shares of common stock outstanding during the period plus the dilutive effects of stock options.

Options to purchase 0 shares, 304,500 shares and 300,939 shares of common stock with exercise prices greater than the average market prices of common stock were outstanding at December 31, 1998, 1999 and 2000, respectively. These options were excluded from the respective computations of diluted net loss per share because their effect would be anti-dilutive.

The following table sets forth the computation of basic and diluted net loss per share for the periods indicated:

	Year Ended December 31,		
	1998	1999	2000
Numerator:			
Net income (loss)	\$ (1,581,000)	\$ (8,045,000)	\$ 10,109,000
Denominator for basic earnings (loss) per share:			
Weighted average shares	16,661,088	20,066,066	23,456,088
Denominator for diluted earnings (loss) per share:			
Effect of dilutive securities — stock options	—	—	10,761
Weighted average shares adjusted for dilutive securities	16,661,088	20,066,066	23,466,849
Basic and diluted earnings (loss) per share	\$ (0.09)	\$ (0.40)	\$ 0.43

### Concentrations of Business and Credit Risks

The majority of the Company's operations are conducted in several locations across the country. The Company's credit risk is spread across a large number of customers, none of which account for a significant volume of revenue or outstanding receivables. The Company does not normally require collateral on credit sales; however, credit histories are reviewed before extending substantial credit to any customer. The Company establishes an allowance for doubtful accounts based on customers' payment history and perceived credit risks. Bad debts have been within management's expectations.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

### Reclassifications

Certain reclassifications were made to the prior year financial statements to conform to the current year presentation.

## 2. ACQUISITIONS AND DISPOSITIONS OF ASSETS

Pro forma information to present operating results as if the acquisitions discussed below had occurred at the beginning of the year acquired is not presented because the Company generally changes the programming format of the radio stations such that the source and nature of revenue and operating expenses are significantly different than they were prior to the acquisition and, accordingly, historical and pro forma financial information has not been considered meaningful by management. Pro forma and historical financial information of radio stations acquired where the format was not changed and of other media businesses acquired have not been significant to the consolidated financial position or operating results of the Company.

The Company used the purchase method of accounting for all of the acquisitions described below, and, accordingly, the operating results of the acquired assets and businesses are included in the consolidated operating results since the dates of acquisition.

During the year ended December 31, 2000, the Company purchased the assets (principally intangibles) of the following radio stations:

Acquisition Date	Station	Market Served	Allocated Purchase Price
<i>(in thousands)</i>			
January 4, 2000	WNIV-AM & WLTA-AM	Atlanta, GA	\$ 8,000
January 10, 2000	WABS-AM	Washington, D.C.	4,100
January 25, 2000	KJQI-FM	San Francisco, CA	8,000
February 15, 2000	KAIM-AM/FM	Honolulu, HI	1,800
February 16, 2000	KHNR-AM & KGU-AM	Honolulu, HI	1,700
April 4, 2000	WGKA-AM	Atlanta, GA	8,000
June 30, 2000	KSKY-AM	Dallas, TX	13,000
August 24, 2000 (1)	KALC-FM	Denver, CO	100,000
August 24, 2000 (1)	KDGE-FM	Dallas, TX	33,271
August 24, 2000 (1)	WYGY-FM	Cincinnati, OH	18,109
August 24, 2000 (1)	KEZY-AM <i>(now KXMX-AM)</i>	Anaheim, CA	12,449
August 24, 2000 (1)	KXMX-FM <i>(now KFSH-FM)</i>	Anaheim, CA	9,069
August 24, 2000 (1)	WKNR-AM	Cleveland, OH	7,437
August 24, 2000 (1)	WRMR-AM	Cleveland, OH	4,738
August 24, 2000 (1)	WBOB-AM	Cincinnati, OH	527
October 2, 2000	KCBQ-AM	San Diego, CA	4,250
October 5, 2000	WGTK-AM	Louisville, KY	1,750
			<u>\$ 236,200</u>

(1) These stations were acquired in one transaction for \$185.6 million.

The purchase price has been allocated to the assets acquired as follows:

Asset	Amount
<i>(in thousands)</i>	
Property and equipment	\$ 12,885
Broadcast licenses	222,624
Goodwill and other intangibles	691
	<u>\$ 236,200</u>

On February 25, 2000, the Company purchased the KRLA-AM transmitter site in Los Angeles, CA, for \$2.8 million.

On March 31, 2000, the Company purchased all of the outstanding shares of stock of RSN for \$3.1 million. RSN owns and operates Solid Gospel, a radio broadcasting network that produces and distributes music programming to its own radio stations WBOZ-FM and WVRV-FM, Nashville, TN, and to independent radio station affiliates. RSN also owns and operates SolidGospel.com, a web site on the Internet.

During 2000, the Company sold certain assets of OnePlace resulting in a loss of \$3.5 million recorded in gain (loss) on sale of assets.

On June 30, 2000, the Company exchanged the assets of radio station KPRZ-FM, Colorado Springs, CO, plus \$7.5 million for the assets of radio station KSKY-AM, Dallas, Texas.

On August 22, 2000, the Company sold the assets of radio station KLTX-AM, Los Angeles, CA for \$29.5 million to a corporation owned by one of our Board members, resulting in a gain of \$28.8 million.

On September 1, 2000, the Company exchanged the assets of radio station KKHT-FM, Houston, TX for the assets of radio stations WALR-FM (now WFSH-FM), Atlanta, GA, KLUP-AM, San Antonio, TX, and WSUN-AM, Tampa, FL. No gain or loss was recognized on this transaction.

On November 9, 2000, the Company entered into an agreement to exchange the assets of radio station WHK-AM, Cleveland, OH and WHK-FM, Canton, OH plus \$10.5 million for the transmitting facility of radio station WCLV-FM, Cleveland, OH. The Company anticipates this transaction to close in the first half of 2001.

On November 20, 2000, the Company exchanged the assets of radio station KDGE-FM, Dallas, TX for the assets of radio station KLTY-FM, Dallas, TX. No gain or loss was recognized on this transaction.

During the year ended December 31, 1999, the Company purchased the assets (principally intangibles) of the following radio stations:

Acquisition Date	Station	Market Served	Allocated Purchase Price
<i>(in thousands)</i>			
April 30, 1999	KKOL-AM	Seattle, WA	\$ 1,750
July 23, 1999	KCTK-AM	Phoenix, AZ	5,000
September 13, 1999	WLSY-FM	Louisville, KY	2,500
September 13, 1999	WRVI-FM	Louisville, KY	2,500
			<u>\$ 11,750</u>

The purchase price has been allocated to the assets acquired as follows:

Asset	Amount
<i>(in thousands)</i>	
Property and equipment	\$ 2,160
Broadcast licenses	9,557
Goodwill and other intangibles	33
	<u>\$ 11,750</u>

In addition to the stations above, in January 1999, the Company purchased the assets of OnePlace for \$6.2 million, and all the outstanding shares of stock of CCM for \$1.9 million. The purchases were financed primarily by an additional borrowing.

On March 11, 1999, the Company acquired the assets of Christian Research Report ("CRR") for \$300,000. The publications of CRR follow the contemporary Christian music industry.

On August 25, 1999, the Company purchased the assets of the Internet sites AudioCentral.com and ChristianBooks.com for \$400,000 cash and \$600,000 non-cash consideration.

On October 19, 1999, the Company acquired the assets of Gospel Media Network, Inc., relating to the audio and video streaming of content on the GospelMedia.com Internet site, for \$475,000.

On November 30, 1999, the Company acquired the assets of the Involved Christian Radio Network, which provides streaming media on its Internet site, ICRN.com, for \$3.0 million.

The revenue and operating expenses of these businesses are reported as "other media" on our consolidated statements of operations.

The table below summarizes the other media acquisitions during 1999:

Acquisition Date	Entity	Allocated Purchase Price (in thousands)
January 29, 1999	OnePlace	\$ 6,150
January 29, 1999	CCM	1,886
March 11, 1999	Christian Research Report	300
August 25, 1999	AudioCentral	1,000
October 19, 1999	Gospel Media Network, Inc.	475
November 30, 1999	Involved Christian Radio Network	3,000
		<u>\$ 12,811</u>

The purchase price has been allocated to the assets acquired and liabilities assumed as follows:

	Amount (in thousands)
<b>Assets</b>	
Accounts receivable and other current assets	\$ 1,453
Property, plant, equipment and software	5,764
Subscriber base and domain names	2,246
Goodwill and other intangible assets	8,790
Other assets	607
	<u>18,860</u>
<b>Liabilities</b>	
Accounts payable and other current liabilities	(3,437)
Other long-term liabilities	(2,612)
	<u>(6,049)</u>
Purchase price	<u>\$ 12,811</u>

During the year ended December 31, 1998, the Company purchased the assets (principally intangibles) of the following radio stations:

Acquisition Date	Station	Market Served	Allocated Purchase Price (in thousands)
August 21, 1998	KKMO-AM	Tacoma, WA	\$ 500
August 26, 1998	KIEV-AM (now KRLA-AM)	Los Angeles, CA	33,210
October 30, 1998	KYCR-AM	Minneapolis, MN	500
October 30, 1998	KTEK-AM	Houston, TX	2,061
			<u>\$ 36,271</u>

The purchase price has been allocated to the assets acquired as follows:

Assets	Amount (in thousands)
Property and equipment	\$4,507
Broadcast licenses	29,627
Goodwill and other intangibles	2,137
	<u>\$36,271</u>

In 1998, the Company sold the assets (principally intangibles) of radio stations KTSL-FM, Spokane, WA, for \$1.3 million and KAVC-FM, Lancaster, CA, for \$1.6 million.

### 3. DUE FROM STOCKHOLDERS

The amounts due from stockholders represent short-term advances made to stockholders of the Company.

### 4. PROPERTY, PLANT, EQUIPMENT AND SOFTWARE

Property, plant, equipment and software consisted of the following at December 31:

	December 31, 1999 2000 (in thousands)	
Land	\$ 1,974	\$ 4,341
Buildings	1,742	3,335
Office furnishings and equipment	12,952	16,041
Antennae, towers & transmitting equipment	32,672	38,023
Studio and production equipment	18,613	20,026
Computer software	4,427	2,528
Record and tape libraries	527	534
Automobiles	166	298
Leasehold improvements	4,877	6,182
Construction-in-progress	4,658	14,357
	<u>82,608</u>	<u>105,665</u>
Less accumulated depreciation	31,943	36,661
	<u>\$ 50,665</u>	<u>\$ 69,004</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 5. LONG-TERM DEBT

Long-term debt consisted of the following at:

	December 31,	
	1999	2000
	(in thousands)	
Revolving line of credit with banks	\$ —	\$ 186,050
9 1/2% Senior Subordinated Notes due 2007	100,000	100,000
Obligation to acquire KRLA-AM property	2,810	—
Capital leases acquired through OnePlace	344	93
Seller financed note to acquire Gospel Media	181	—
	103,335	286,143
Less current portion	3,248	93
	\$ 100,087	\$ 286,050

Since the revolving line of credit with banks carries a floating interest rate, the carrying amount approximates its fair market value. The Notes were issued in September 1997 at par. At December 31, 2000, the fair market value of the Notes was approximately \$95.0 million.

#### Revolving Line of Credit with Banks

HoldCo has a credit agreement with a syndicate of lending institutions (the "Credit Agreement") to provide for borrowing capacity of up to \$225 million under a revolving line of credit. The maximum amount that HoldCo may borrow under the Credit Agreement is limited by a ratio of HoldCo's existing adjusted debt to pro forma twelve-month cash flow, as defined in the Credit Agreement (the Adjusted Debt to Cash Flow Ratio). At December 31, 2000, the maximum Adjusted Debt to Cash Flow Ratio allowed under the Credit Agreement was 6.50 to 1.00. At December 31, 2000, the Adjusted Debt to Cash Flow Ratio was 5.45 to 1.00, resulting in total borrowing availability of approximately \$39.0 million. The maximum Adjusted Debt to Cash Flow Ratio allowed under the Credit Agreement is 6.50 to 1 through December 30, 2001. Thereafter, the maximum ratio will decline periodically until December 31, 2005, at which point it will remain at 4.00 to 1 through June 2007.

The note underlying the revolving line of credit bears interest at a fluctuating base rate plus a spread that is determined by Salem's Adjusted Debt to Cash Flow Ratio. At HoldCo's option, the base rate is either a bank's prime rate or LIBOR. For purposes of determining the interest rate the prime rate spread ranges from 0% to 1.5%, and the LIBOR spread ranges from .875% to 2.75%. Interest is payable quarterly. Commencing March 31, 2002, and every quarter thereafter, the commitment under the Credit Agreement reduces by increasing amounts through June 30, 2007, when it expires.

The Credit Agreement with the banks (a) provides for restrictions on additional borrowings and leases; (b) prohibits Salem, without prior approval from the banks, from paying dividends, liquidating, merging, consolidating or selling its assets or business, and (c) requires HoldCo to maintain certain financial ratios and other covenants. Salem has pledged all of its assets as collateral under the Credit Agreement. Additionally, all the Company's stock holdings in its subsidiaries are pledged as collateral.

In July 1999, the Company used a portion of the net proceeds from its initial public offering to repay all amounts due under a previous revolving line of credit with the banks, and to repurchase \$50 million principal amount of the Notes. The Company wrote off certain

deferred financing costs (including bond issue costs of \$1.5 million) and paid a premium of \$3.9 million on the Notes. The write-off and premium of \$3,570,000, net of a \$1,986,000 income tax benefit, was recorded as an extraordinary item in the accompanying statement of operations for the year ended December 31, 1999.

#### 9 1/2% Senior Subordinated Notes due 2007

On August 24, 2000, the Company supplemented the indenture for the senior subordinated notes in connection with the assignment of substantially all of the assets and liabilities of the Company to HoldCo, including the obligations as successor issuer under the indenture.

The Notes bear interest at 9 1/2% per annum, with interest payment dates on April 1 and October 1, commencing April 1, 1998. Principal is due on the maturity date, October 1, 2007. The Notes are redeemable at the option of the Company, in whole or in part, at any time on or after October 1, 2002, at the redemption prices specified in the indenture. The Notes are fully and unconditionally guaranteed, jointly and severally, on a senior subordinated basis by the Guarantors (the HoldCo subsidiaries). The Notes are general unsecured obligations of the Company, subordinated in right of payment to all existing and future senior indebtedness, including the Company's obligations under the Credit Agreement. The indenture limits the incurrence of additional indebtedness by the Company, the payment of dividends, the use of proceeds of certain asset sales, and contains certain other restrictive covenants affecting the Company.

#### Bridge Loan

In order to finance the eight radio stations acquired on August 24, 2000, the Company borrowed \$58 million under a bridge loan provided by ING (U.S.) Capital, LLC as Agent. The entire amount borrowed was due on August 24, 2001. On November 7, 2000, the Company paid off the bridge loan using available cash, interest reserves and \$48.3 million of borrowing under the existing credit facility. In connection with the repayment of the bridge loan, the Company wrote-off certain deferred financing costs. The write-off of \$1,187,000, net of a \$662,000 income tax benefit, was recorded as an extraordinary item in the accompanying statement of operations for the year ended December 31, 2000.

#### Other Debt

In August 1998, in connection with the Company's acquisition of KRLA-AM, the Company agreed to lease the real property on which the station's towers and transmitter are located for \$10,000 per month. The Company also agreed to purchase the property for \$3 million in February 2000. The Company recorded this transaction in a manner similar to a capital lease. The amount recorded as a long-term obligation at December 31, 1998, represents the present value of the future commitments under the lease and purchase contract, discounted at 8.5%. The obligation is classified as current at December 31, 1999 and was paid in February 2000.

In connection with the acquisition of OnePlace in January 1999, the Company acquired several capital leases related to various data processing equipment. The obligation recorded at December 31, 1999 and 2000 represents the present value of future commitments under the lease agreements.

In connection with the acquisition of Gospel Media Network, Inc. ("Gospel Media"), the Company incurred an obligation to make future payments to the seller. The Company sold Gospel Media on August 14, 2000. As part of the sale agreement, these future commitments were forgiven.

### Maturities of Long-Term Debt

Principal repayment requirements under all long-term debt agreements outstanding at December 31, 2000, for each of the next five years and thereafter are as follows:

2001	\$93
2002	—
2003	—
2004	—
2005	—
Thereafter	286,050
	<u>\$286,143</u>

### 6. INCOME TAXES

In connection with the 1999 acquisition of CCM the Company recorded a net deferred tax liability of \$1,468,000 and in connection with the 2000 acquisition of RSN, the Company recorded a net deferred tax liability of \$739,000, which amounts were recorded as an increase to the deferred tax liability and is not reflected in the income tax benefit in 1999 and the income tax provision in 2000.

The consolidated provision (benefit) for income taxes for Salem consisted of the following at December 31:

	1998	1999	2000
	<i>(in thousands)</i>		
<b>Current:</b>			
Federal	\$ —	\$ —	\$ —
State	387	509	543
	<u>387</u>	<u>509</u>	<u>543</u>
<b>Deferred:</b>			
Federal	(467)	(3,507)	5,330
State	(263)	(599)	461
	<u>(730)</u>	<u>(4,106)</u>	<u>5,791</u>
Current tax benefit reflected in net extraordinary loss	—	(1,986)	(662)
Income tax provision (benefit)	\$ (343)	\$ (1,611)	\$ 6,996

The consolidated deferred tax asset and liability consisted of the following at December 31:

	1999	2000
	<i>(in thousands)</i>	
<b>Deferred tax assets:</b>		
Financial statement accruals not currently deductible	\$ 1,140	\$ 2,233
Net operating loss. AMT credit and other carryforwards	5,413	10,060
State taxes	176	185
Other	537	462
Total deferred tax assets	7,266	12,940
Valuation allowance for deferred tax assets	(860)	(2,057)
Net deferred tax assets	6,406	10,883
<b>Deferred tax liabilities:</b>		
Excess of net book value of property, plant, equipment and software for financial reporting purposes over tax basis	4,292	3,851
Excess of net book value of intangible assets for financial reporting purposes over tax basis	7,842	19,267
Other	772	794
Total deferred tax liabilities	12,906	23,912
Net deferred tax liabilities	\$ 6,500	\$ 13,029

A reconciliation of the statutory federal income tax rate to the effective tax rate, as a percentage of income before income taxes, is as follows:

	<b>Year Ended December 31,</b>		
	1998	1999	2000
Statutory federal income tax rate	(34)%	(34)%	35%
State income taxes, net	4	1	4
Nondeductible expenses	7	7	1
Exclusion of income taxes of S corporations and the Partnership	—	—	—
Change in taxable entity (S corporation to C corporation)	—	—	—
Other, net	5	—	(2)
	<u>(18)%</u>	<u>(26)%</u>	<u>38%</u>

At December 31, 2000, the Company has net operating loss carryforwards for federal income tax purposes of approximately \$22,200,000 which expire in years 2010 through 2020 and for state income tax purposes of approximately \$52,100,000 which expire in years 2002 through 2020. The Company has federal alternative minimum tax credit carryforwards of approximately \$147,000. For financial reporting purposes at December 31, 2000 the Company has a valuation allowance of \$2,057,000 to offset a portion of the deferred tax assets related to the state net operating loss carryforwards.

### 7. COMMITMENTS AND CONTINGENCIES

Salem leases various land, offices, studios and other equipment under operating leases that expire over the next 10 years. The majority of these leases are subject to escalation clauses and may be renewed for successive periods ranging from one to five years on terms similar to current agreements and except for specified increases in lease payments. Rental expense included in operating expense under all lease agreements was \$4,800,000, \$6,000,000 and \$7,400,000 in 1998, 1999, and 2000, respectively.

Future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of December 31, 2000, are as follows:

	Related Parties	Other	Total
	<i>(in thousands)</i>		
2001	\$ 1,148	\$ 5,201	\$ 6,349
2002	1,002	4,428	5,430
2003	919	4,154	5,073
2004	739	3,934	4,673
2005	667	3,039	3,706
Thereafter	1,445	13,631	15,076
	<u>\$ 5,920</u>	<u>\$ 34,387</u>	<u>\$ 40,307</u>

The Company had a deferred compensation agreement with one of its officers, which would have provided for retirement payments to the officer for a period of ten consecutive years, if he remained employed by the Company until age 60. The retirement payments were based on a formula defined in the agreement. The estimated obligation under the deferred compensation agreement was being provided for over the service period. At December 31, 1998 and 1999, a liability of approximately \$432,000 and \$494,000 respectively, is included in other liabilities in the accompanying balance sheet for the amounts earned under this agreement. The officer terminated

his employment with the Company in 2000 and therefore there is no liability recorded as of December 31, 2000. Corporate expenses were reduced by \$404,000 in 2000 due to the termination of this agreement.

The Company and its subsidiaries, incident to its business activities, are parties to a number of legal proceedings, lawsuits, arbitration and other claims, including the Gospel Communications International, Inc. ("GCI") matter described in more detail below. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Also, the Company maintains insurance which may provide coverage for such matters. Consequently, the Company is unable to ascertain the ultimate aggregate amount of monetary liability or the financial impact with respect to these matters as of December 31, 2000. However, the Company believes, at this time, that the final resolution of these matters, individually and in the aggregate, will not have a material adverse effect upon the Company's annual consolidated financial position, results of operations or cash flows.

On December 6, 2000, GCI made a demand for arbitration upon Salem. The demand, pending before an arbitration panel of the American Arbitration Association, alleges Salem and its subsidiary OnePlace, Ltd. failed to provide certain e-commerce software to GCI pursuant to a written contract between GCI and OnePlace, for which GCI seeks \$5.0 million in damages. The Company has filed an answer to the demand, denying the factual basis for certain elements of GCI's claims and has asserted counterclaims against GCI for breach of contract. By consent of the parties, the matter has been submitted to nonbinding mediation. Although there can be no assurance that the GCI matter will be resolved in favor of the Company, Salem will vigorously defend the action and pursue its counterclaims against GCI.

### 8. STOCK OPTION PLAN

The 1999 Stock Incentive Plan (the "Plan") allows the Company to grant stock options to employees, directors, officers and advisors of the Company. A maximum of 1,000,000 shares were authorized under the Plan. Options generally vest over five years and have a maximum term of 10 years. The Plan provides that vesting may be accelerated in certain corporate transactions of the Company. The Plan provides that the Board of Directors, or a committee appointed by the Board, has discretion, subject to certain limits, to modify the terms of outstanding options. At December 31, 2000, the Company had 644,500 shares available for future grants under its Plan.

A summary of stock option activity is as follows:

	Options	Weighted Average Exercise Price	Exercisable Options	Weighted Average Exercise Price
Outstanding at December 31, 1998	—	—	—	—
Granted	304,500	\$ 22.65	—	—
Outstanding at December 31, 1999	304,500	\$ 22.65	—	—
Granted	110,000	\$ 16.32	—	—
Cancelled	102,800	\$ 22.86	—	—
Outstanding at December 31, 2000	311,700	\$ 20.35	51,020	\$ 22.53

Additional information regarding options outstanding as of December 31, 2000, is as follows:

Range of Exercise Prices	Options	Weighted Average Contractual Life Remaining (Years)	Weighted Average Exercise Price	Exercisable Options	Weighted Average Exercise Price
\$10.00 - \$13.00	66,000	9.6	\$12.21	—	—
\$22.50 - \$27.07	245,700	8.6	\$22.54	51,020	\$22.53
\$10.00 - \$27.07	311,700	8.8	\$20.35	51,020	\$22.53

The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Accordingly, no compensation cost has been recognized in the results of operations for the stock option grants. Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date, amortized over the vesting period, for awards in 1999 and 2000 consistent with the provisions of SFAS No. 123, the Company's net income and basic earnings per share would have been reduced to the pro forma amounts as follows:

	Year Ended December 31,		
	1998	1999	2000
Net income (loss)	\$ (1,581)	\$ (8,045)	\$ 10,109
Pro forma net income (loss)	(1,581)	(8,845)	9,262
Pro forma basic and diluted earnings (loss) per share	\$ (0.09)	\$ (0.44)	\$ 0.39

Using the Black-Scholes valuation model, the per share weighted-average fair value of stock options granted during the years ended December 31, 1999 and 2000 was \$11.36 and \$9.36, respectively. The pro forma effect on the Company's net loss and basic and diluted loss per share for 1999 and 2000 is not representative of the pro forma effect in future years. The fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants made in 1999: dividend yield of 0%; expected volatility of 58.0%; risk-free interest rate of 5.8%; expected life of 4 years. The following assumptions were made for grants made in 2000: dividend yield of 0%; expected volatility of 96.0%; risk-free interest rate of 5.8%; expected life of 4 years. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options. The assumptions used in option valuation models are highly subjective, particularly the expected stock price volatility of the underlying stock. Because changes in these subjective input assumptions can materially affect the fair value estimate, in management's opinion the existing models do not provide a reliable single measure of the fair value of its employee stock options.

### 9. RELATED PARTY TRANSACTIONS

In December 1998, the Company borrowed \$1.8 million from a stockholder pursuant to a promissory note with a revolving principal amount of up to \$2.5 million. The outstanding balance on the note as of December 31, 1998 was \$1.8 million (see Note 5). The note was repaid in full and cancelled in April 1999.

A stockholder's trust owns real estate on which certain assets of two radio stations are located. One of the stations, KAVC-FM, was sold during 1998. Salem, in the ordinary course of its business, entered into two separate lease agreements with this trust. Rental expense included in operating expense for 1998, 1999 and 2000 amounted to \$60,000, \$48,000 and \$49,000, respectively.

Land and buildings occupied by various Salem radio stations are leased from the stockholders of Salem. Rental expense under these leases included in operating expense for 1998, 1999 and 2000 amounted to \$1.0 million, \$1.4 million and \$1.5 million, respectively.

In June 1997, the Company entered into a local marketing agreement ("LMA") with a corporation, Sonsinger, Inc. ("Sonsinger"), owned by two of Salem's stockholders for radio station KKOL-AM. The stockholders and the Company are parties to an Option to Purchase Agreement whereunder the Company had been granted an option to purchase KKOL-AM from the stockholders at any time on or before December 31, 1999 at a price equal to the lower of the cost of the station to the stockholders, \$1.4 million, and its fair market value as determined by an independent appraisal. The Company acquired KKOL-AM from Sonsinger on April 30, 1999 for \$1.4 million and associated real estate for \$400,000. Under the LMA, Salem programmed KKOL-AM and sold all the airtime. Salem retained all of the revenue and incurred all of the expenses related to the operation of KKOL-AM and incurred approximately \$164,000 and \$43,000 in 1998 and 1999, respectively, in LMA fees to Sonsinger.

On August 22, 2000, the Company sold the assets of radio station KLTX-AM, Los Angeles, CA for \$29.5 million to a corporation owned by one of its Board members, resulting in a gain of \$28.8 million.

On October 5, 2000, the Company acquired the assets of radio station WGTX-AM, Louisville, KY for \$1.8 million from a corporation owned by a relative of one of its Board members.

From time to time, the Company rents an airplane and a helicopter from a company which is owned by one of the principal stockholders. As approved by the independent members of the Company's board of directors, the Company rents these aircraft on an hourly basis at below-market rates and uses them for general corporate needs. Total rental expense for these aircraft for 1998, 1999 and 2000 amounted to approximately \$69,000, \$156,000 and \$149,000, respectively.

#### 10. DEFINED CONTRIBUTION PLAN

In 1993, the Company established a 401(k) defined contribution plan (the "Plan"), which covers all eligible employees (as defined in the Plan). Participants are allowed to make nonforfeitable contributions up to 15% of their annual salary, but may not exceed the annual maximum contribution limitations established by the Internal Revenue Service. The Company currently matches 25% of the amounts contributed by each participant but does not match participants' contributions in excess of 6% of their compensation per pay period. Prior to January 1, 1999, the Company matched 10% of the amounts contributed by each participant but did not match participants' contributions in excess of 10% of their compensation per pay period. The Company contributed and expensed \$87,000, \$237,000 and \$320,000 to the Plan in 1998, 1999 and 2000, respectively.

#### 11. STOCKHOLDERS' EQUITY

On March 31, 1999, the Company changed its domicile from California to Delaware (the "Reincorporation"). In conjunction with the Reincorporation, the Company's capital structure was changed to authorize 80,000,000 shares of Class A common stock, \$0.01 par value, 20,000,000 shares of Class B common stock, \$0.01 par value, and 10,000,000 shares of preferred stock, \$0.01 par value. In the Reincorporation, the previously outstanding 5,553,696 shares of common stock were converted into 11,107,392 shares of Class A common stock and 5,553,696 shares of Class B common stock.

In April 1999, the Company filed a registration statement for an initial public offering (the "Offering") of its Class A common stock with the Securities and Exchange Commission. In connection with the

Offering, the Company's board of directors approved a 67-for-one stock dividend on the Company's Class A and Class B common stock. All references in the accompanying financial statements to Class A and Class B common stock and per share amounts have been retroactively adjusted to give effect to the stock dividend.

Holders of Class A common stock are entitled to one vote per share and holders of Class B common stock are entitled to ten votes per share, except for specified related party transactions. Holders of Class A common stock and Class B common stock vote together as a single class on all matters submitted to a vote of stockholders, except that holders of Class A common stock vote separately for two independent directors.

On May 26, 1999, the Company awarded 75,000 shares of Class A common stock to an officer of the Company. The Company also agreed to pay the individual federal and state income tax liabilities associated with the stock award. The Class A common stock award was valued based on the initial public offering price and along with the compensation resulting from the payment of the individual federal and state income taxes associated with the award was recognized as compensation expense of \$2.6 million during the year ended December 31, 1999.

Upon the closing of the Company's initial public offering, the Company issued 6,720,000 shares of the Company's Class A common stock at \$22.50 per share, generating gross offering proceeds of \$151.2 million. After deducting a \$9.6 million underwriting discount and \$1.5 million in other related expenses, the net proceeds to Salem were \$140.1 million.

In addition, two selling stockholders sold 2,940,000 shares of the Company's Class A common stock (including 1,260,000 shares sold by the stockholders as a result of the exercise by the managing underwriters of their over-allotment option subsequent to the initial offering) to the underwriting syndicate at the same price per share raising gross proceeds of \$66.2 million. After deducting a \$4.2 million underwriting discount the net proceeds to the selling stockholders were \$62.0 million. Salem did not receive any monies from the sale of shares of the Company's Class A common stock by these selling stockholders.

#### 12. SUBSEQUENT EVENTS (UNAUDITED)

Subsequent to December 31, 2000, the Company purchased the assets (principally intangibles) of the following radio stations:

Acquisition Date	Station	Market Served	Allocated Purchase Price
			(in thousands)
February 2, 2001	WXRT-AM	Chicago, IL	\$ 29,000
February 16, 2001	WWTC-AM	Minneapolis, MN	5,000
February 16, 2001	WZER-AM	Milwaukee, WI	2,100
March 9, 2001	WRBP-AM	Warren, OH	500
March 16, 2001	WFIA-AM	Louisville, KY	1,750
			<u>\$ 38,350</u>

On January 17, 2001, the Company entered into an agreement to purchase the assets of radio station WROL-AM, Boston, MA, for \$11 million. The Company anticipates this transaction to close in the first half of 2001.

On January 22, 2001, the Company sold the assets of radio station KALC-FM, Denver, CO for \$100 million.



**13. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED):**

	<b>March 31</b>		<b>June 30</b>		<b>September 30</b>		<b>December 31</b>	
	1999	2000	1999(1)	2000	1999	2000(2)	1999	2000
	<i>(in thousands, except per share data)</i>							
Total revenue	\$ 21,520	\$ <b>24,400</b>	\$ 22,718	\$ <b>26,824</b>	\$ 23,100	\$ <b>29,811</b>	\$ 26,208	\$ <b>36,979</b>
Net operating income	2,936	<b>158</b>	(89)	<b>1,130</b>	2,345	<b>1,569</b>	2,788	<b>3,644</b>
Net income (loss) before extraordinary item	(1,308)	<b>(1,657)</b>	(3,516)	<b>1,601</b>	(138)	<b>13,786</b>	487	<b>(2,399)</b>
Extraordinary loss	—	—	—	—	(3,570)	—	—	<b>(1,187)</b>
Net income (loss)	\$ (1,308)	\$ <b>(1,657)</b>	\$ (3,516)	\$ <b>1,601</b>	\$ (3,708)	\$ <b>13,786</b>	\$ 487	\$ <b>(3,586)</b>
Basic and diluted earnings (loss) per share before extraordinary item	\$ (0.08)	\$ <b>(0.07)</b>	\$ (0.21)	\$ <b>0.07</b>	\$ (0.01)	\$ <b>0.59</b>	\$ 0.02	\$ <b>(0.10)</b>
Extraordinary loss per share	—	—	—	—	(0.15)	—	—	<b>(0.05)</b>
Basic and diluted earnings (loss) per share	\$ (0.08)	\$ <b>(0.07)</b>	\$ (0.21)	\$ <b>0.07</b>	\$ (0.16)	\$ <b>0.59</b>	\$ 0.02	\$ <b>(0.15)</b>

(1) Includes a charge of \$2.6 million (\$1.9 million net of tax) related to stock and related cash award made during the quarter.

(2) Includes a gain of \$28.8 million on the sale of the assets of radio station KLTX-AM, Los Angeles, CA to a corporation owned by one of its Board members.

**REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS**

The Board of Directors and Stockholders  
of Salem Communications Corporation

We have audited the accompanying consolidated balance sheets of Salem Communications Corporation (the "Company") as of December 31, 1999 and 2000, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Salem Communications Corporation at December 31, 1999 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

Woodland Hills, California  
March 5, 2001

*Ernst & Young LLP*

## BOARD OF DIRECTORS

Stuart W. Epperson  
*Chairman of the Board*

Edward G. Atsinger III  
*President and Chief Executive Officer*

Eric H. Halvorson  
*Consultant / University Professor*

Roland S. Hinz  
*Publisher / Editor-in-Chief  
Hi-Torque Publishing*

Donald P. Hodel  
*Managing Director  
Summit Group International, Ltd*

Richard A. Riddle  
*Consultant / Independent Businessman*

Joseph S. Schuchert  
*Chairman  
Kelso & Company, Inc.*

## EXECUTIVE OFFICERS OF THE CORPORATON

Stuart W. Epperson  
*Chairman of the Board*

Edward G. Atsinger III  
*President and Chief Executive Officer*

Joe D. Davis  
*Senior Vice President  
Operations*

David Evans  
*Senior Vice President and  
Chief Financial Officer*

Russell R. Hauth  
*Senior Vice President  
Administration and Public Affairs*

George Toulas  
*Senior Vice President  
Special Projects*

Jonathan L. Block  
*Vice President,  
Secretary and  
General Counsel*

Eileen E. Hill  
*Vice President  
Finance and Accounting*

Roger Kemp  
*Vice President  
National Program Development  
& Ministries Relations*

Rob Adair  
*Vice President  
Operations*

Dave Armstrong  
*Vice President  
Operations  
and General Manager / KKLA-FM,  
KXMX-AM, KEZY-AM, KRLA-AM  
and KFSH-FM*

Kenneth L. Gaines  
*Vice President  
Operations*

David Ruleman  
*Vice President  
Operations  
and General Manager / WAVA-FM,  
WITH-AM, and WABS-AM*

Greg R. Anderson  
*President  
Salem Radio Network*

James R. Cumbee  
*President  
Non-Broadcast Media*

John W. Styll  
*President  
CCM Communications, Inc.*

## EXECUTIVE OFFICES

4880 Santa Rosa Road, Suite 300  
Camarillo, CA 93012  
(805) 987-0400

## CORPORATE COUNSEL

Gibson, Dunn & Crutcher LLP  
Jamboree Center  
4 Park Plaza  
Irvine, CA 92614

## INDEPENDENT AUDITORS

Ernst & Young LLP  
Warner Corporate Center  
21800 Oxnard Street  
Suite 500  
Woodland Hills, CA 91367-7534

## TRANSFER AGENT AND REGISTRAR

Information concerning the transfer or exchange of stock, lost certificates, change of address and other share transfer matters should be directed to Salem's transfer agent at:

The Bank of New York  
101 Barclay Street  
12<sup>th</sup> Floor  
New York, NY 10286

## SHAREHOLDER CONTACT & FINANCIAL INFORMATION

Jalane R. Sclafani  
Director of Communications and  
Investor Relations  
Salem Communications Corporation  
4880 Santa Rosa Road  
Suite 300  
Camarillo, CA 93012

## ANNUAL REPORT

A copy of Salem's 2000 Annual Report on Form 10-K (without exhibits) filed with the Securities and Exchange Commission is available to stockholders without charge, upon written request to:

Jonathan L. Block  
Salem Communications Corporation  
4880 Santa Rosa Road  
Suite 300  
Camarillo, CA 93012

## ANNUAL MEETING

The Annual Meeting of Shareholders will be held at 10:00 a.m., on June 6, 2001, at the Ronald Reagan Presidential Library, 40 Presidential Drive, Simi Valley, California



4880 Santa Rosa Road  
Suite 300  
Camarillo, CA 93012



## Investor Relations

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## PRESS RELEASES

Salem Communications Corporation (ticker: SALM, exchange: NASDAQ) News Release - 8-Aug-2001

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**Salem Communications Announces Record Second Quarter 2001 Results**

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CAMARILLO, Calif., Aug. 8 /PRNewswire/ -- Salem Communications Corporation (Nasdaq: SALM), the leading radio broadcaster focused on religious and family issues programming, announced today results for the second quarter ended June 30, 2001.

Commenting on the second quarter results, Edward G. Atsinger III, Salem's Chief Executive Officer, said, "Our strong second quarter results highlight the strength of our unique business model. Our second quarter same station revenue increase of 10.5% demonstrates Salem's ability to deliver strong results in a challenging economic environment.

Mr. Atsinger continued: "Our long-term outlook is also very positive. Our 11 stations with recently launched music formats have continued to improve their ratings performance and we are pleased with our progress to date. Our new music stations in Cincinnati and Atlanta both reached a cash flow positive position this quarter as planned. In addition, we have been very active on the acquisition front. As a result, approximately half of our portfolio is currently in a launch or development stage including a number of recent acquisitions set to launch in our music format. These assets will drive future substantial revenue and cash flow growth."

**Second Quarter Results**

For the quarter ended June 30, 2001 net broadcasting revenue increased 36.7% to \$33.9 million from \$24.8 million in the same period a year ago. Broadcast cash flow increased 12.4% to \$12.7 million from \$11.3 million in the corresponding 2000 period.

Broadcast cash flow as a percentage of net revenues decreased to 37.5% in the second quarter of 2001 from 45.6% in the second quarter of 2000. This was due to the impact of recently acquired radio stations that are currently operating at lower margins than pre-existing stations. The company expects this percentage to improve as these recently acquired radio stations grow and mature.

On a same station basis, net broadcasting revenue and broadcast cash flow increased 10.5% and 7.8% respectively, for the second quarter of 2001 as compared to the second quarter of 2000.

The company's non-broadcast media businesses, OnePlace.com and CCM Communications, generated a loss of \$0.4 million for the quarter, before depreciation and amortization, compared to a loss of \$2.0 million for the same period in 2000.

EBITDA, including the company's non-broadcast media businesses, increased to \$8.9 million in the second quarter of 2001 compared to \$6.5 million in 2000.

After tax cash flow increased to \$5.1 million, or \$0.22 per share, for the second quarter of 2001 compared to \$3.7 million, or \$0.16 per share, for the comparable 2000 period.

The company reported a net loss of \$1.3 million for the quarter, or \$0.06 loss per share, compared with net income of \$1.6 million, or \$0.07 income per share, in the same period last year.

Per share numbers were calculated based on 23,456,088 weighted average shares for the quarter ended June 30, 2001, and for the comparable 2000 period.

#### Year to Date 2001 Results

For the six months ended June 30, 2001, net broadcasting revenue increased 35.0% to \$64.0 million from \$47.4 million in the same period a year ago. Broadcast cash flow increased 8.5% to \$23.0 million from \$21.2 million in the comparable 2000 period. Broadcast cash flow as a percentage of net revenue decreased to 35.9% for the six months ended June 30, 2001 for 44.7% in the same period one year ago.

For the six months ended June 30, 2001, same station net broadcasting revenue and broadcast cash flow increased 11.0% and 9.7%, respectively, as compared to the comparable 2000 period.

The company's non-broadcast media businesses generated a loss of \$0.9 million for the six months ended June 30, 2001, before depreciation and amortization, compared to a loss of \$4.3 million in the comparable 2000 period.

EBITDA, including the company's non-broadcast media businesses, increased to \$14.7 million in the six months ended June 30, 2001, compared to \$11.6 million in the comparable 2000 period.

After tax cash flow was \$7.7 million, or \$0.33 per share for the six months of 2001 compared to \$7.6 million, or \$0.32 per share, for the comparable 2000 period.

The company reported a net loss of \$6.0 million for the six months ended June 30, 2001, or \$0.26 loss per share, compared with a net loss of \$0.1 million, or \$0.00 loss per share in the comparable 2000 period.

Per share numbers were calculated based on 23,456,088 weighted average shares for the six months ended June 30, 2001, and for the comparable 2000 period.

#### Station Acquisitions and Sales

Additionally, since last quarter, Salem announced it had entered into and/or completed a number of acquisitions and sales of radio stations including:

- The completion of the acquisition of the Dame-Gallagher Networks.
- The completion of the acquisition of KSFB-AM (formerly KBZS-AM) in Palo Alto, CA from In Radio License, LLC for \$8.5 million.
- The completion of the acquisition of WBTK-AM (formerly WVBB-AM) in Richmond, VA from Cox Radio for \$735,000.
- The pending acquisition of KKFS-FM (formerly KLNA-FM) in Sacramento, CA from Pacific Spanish Network Inc. for \$8.65 million, which we are currently operating under a Local Marketing Agreement with an option to buy.
- The completion of the acquisition of WFHM-FM (formerly WCLV-FM) in Cleveland, OH from Radio Seaway and the sale of WHK-FM in Canton, OH and WHK-AM in Cleveland, OH to Clear Channel Communications and Radio Seaway respectively.
- The pending acquisition of WTNB-AM in Tampa, FL from Synchronous Media Group Inc. for \$6.75 million, which we are currently operating under a Local Marketing Agreement.
- The pending acquisition of KSZZ-AM in San Bernardino, CA from Entravision Communications Corp. for \$7.0 million and the pending sale of KEZY-AM in San Bernardino, CA to Hi-Favor Broadcasting LLC for \$4.0 million.
- The pending acquisition of KJUN-FM in Portland, OR from Thunderegg Wireless LLC for \$35.8

million.

As a result, Salem now owns and/or operates 56 radio stations in the top 25 markets, making it the third largest top 25 market radio operator in terms of number of stations.

#### Third Quarter and Year End 2001 Outlook

Salem achieved same station revenue growth of 8.0% for July 2001. Salem continues to expect third quarter same station revenue growth of approximately 10%.

Based on current pacings, Salem expects net broadcast revenues and broadcast cash flow for the third quarter of 2001 to be approximately \$35.0 million and \$13.3 million, respectively. Also, Salem is projecting after tax cash flow of \$0.23 per share for the third quarter.

For the year ending December 31, 2001, Salem is projecting net broadcasting revenue of \$138.5 million for 2001, a 25.8% increase from \$110.1 million for 2000. Broadcast cash flow is projected to increase to \$52.0 million, a 5.3% increase from \$49.4 million in 2000. Projected broadcast cash flow is negatively impacted by start-up costs and investment spending associated with our recently acquired stations as well as the launch of our music formatted stations.

Salem continues to expect same station revenue and broadcast cash flow growth of 10% and 12% respectively, for full year 2001.

The company's non-broadcast media businesses are projected to generate a loss of \$1.3 million for 2001 compared to \$7.0 million in 2000.

EBITDA, including the company's non-broadcast media businesses, is projected to increase to \$37.0 million in 2001, an increase of 15.6% from \$32.0 million in 2000.

After tax cash flow is projected to be \$0.87 per share for 2001 compared to \$0.81 per share for 2000.

Third quarter and full year 2001 guidance has been updated to reflect the following:

- Start up costs associated with the acquisition and launch of our new music stations in Portland, Sacramento, and Milwaukee.
- A delay in the closing of the acquisition of WZFS-FM in Chicago and WFHM-FM in Cleveland.
- Soft national advertising revenues at KLTY-FM in Dallas, which was acquired by Salem in November 2000, due to the weak advertising environment and a 1.7 rating in the Fall book 2000. Ratings have subsequently improved to a 3.1 rating in Spring book 2001 and revenue and cash flow are expected to fully recover in 2002.

Edward G. Atsinger III commented: "We are very confident about our prospects for the remainder of 2001 and beyond. Our expectations for continued 10% same station revenue growth is a testament to our unique position in radio. This is especially significant in light of the weak advertising climate being felt throughout the radio sector. In addition, our recent acquisitions provide us with an opportunity to attain above average revenue and cash flow growth in the quarters ahead."

Salem will host a teleconference to discuss third quarter results today at 11:00 AM Eastern Time. To access this teleconference live, please visit the company's web site at <http://www.salem.cc> or dial 212-676-5185. A replay of the teleconference will be archived on the company's web site or will be available through August 15th by dialing 800-633-8284, reservation # 19462011.

Salem Communications Corporation is headquartered in Camarillo, California. Upon the close of all announced transactions, the company will own and/or operate 81 radio stations, including 56 stations in the top 25 markets. In addition to its radio properties, Salem owns the Salem Radio Network, which syndicates talk programming, news and music to more than 1,600 affiliated radio stations throughout the United States; OnePlace.com, the leading internet provider of Christian radio content; and CCM Communications, a leading publisher of contemporary Christian music trade and consumer publications.

## Forward-Looking Statements

Statements used in this press release that relate to future plans, events, financial results, prospects or performance are forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those anticipated as a result of certain risks and uncertainties, including but not limited to the ability of Salem to close and integrate announced transactions, market acceptance of recently launched music formats, competition in the radio broadcast, Internet and publishing industries and from new technologies, adverse economic conditions, and other risks and uncertainties detailed from time to time in Salem's periodic reports on Forms 10-K, 10-Q, 8-K and other filings filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Salem undertakes no obligation to update or revise any forward-looking statements to reflect new information, changed circumstances or unanticipated events.

## Salem Communications Corporation

## Condensed Consolidated Statements of Operations

For the Quarter Ended June 30, 2001

(in thousands, except share, per share and other data)

	Three Months Ended June		Six Months Ended June	
	2000	2001	2000	2001
Gross broadcasting revenue	\$27,100	\$37,015	\$51,762	\$69,919
Less agency commissions	2,282	3,126	4,335	5,944
Net broadcasting revenue	24,818	33,889	47,427	63,975
Other media revenue	2,006	2,103	3,797	4,068
Total revenue	26,824	35,992	51,224	68,043
Operating expenses:				
Broadcasting operating expenses	13,506	21,241	26,211	41,091
Other media operating expenses	3,971	2,480	8,115	5,016
Corporate expenses	2,818	3,367	5,272	7,235
Depreciation and amortization	5,399	7,960	10,338	15,233
Total operating expenses	25,694	35,048	49,936	68,575
Net operating income (loss)	1,130	944	1,288	(532)
Other income (expense):				
Interest income	63	759	351	1,554
Gain (loss) on disposal of assets	4,408	2,526	4,408	2,518
Interest expense	(2,699)	(6,282)	(5,219)	(12,749)
Other expense, net	(133)	(107)	(420)	(162)
Income (loss) before income taxes	2,769	(2,160)	408	(9,371)
Provision (benefit) for income taxes	1,168	(813)	464	(3,362)
Net income (loss)	\$1,601	\$ (1,347)	\$ (56)	\$ (6,009)
Basic and diluted net income (loss) per share	\$0.07	\$ (0.06)	\$ (0.00)	\$ (0.26)
Basic and diluted weighted average shares outstanding	23,456,088	23,456,088	23,456,088	23,456,088

Other Data (in thousands,  
except margin and per

share data):				
Broadcast cash flow	\$11,312	\$12,648	\$21,216	\$22,884
Broadcast cash flow margin	45.6%	37.3%	44.7%	35.8%
EBITDA - broadcasting	8,494	9,281	15,944	15,649
EBITDA - other media	(1,965)	(377)	(4,318)	(948)
EBITDA - total	6,529	8,904	11,626	14,701
After-tax cash flow - broadcasting	5,534	5,324	10,228	8,282
After-tax cash flow per share - broadcasting	\$0.24	\$0.23	\$0.44	\$0.35
After-tax cash flow	4,355	5,097	7,637	7,713
After-tax cash flow per share	\$0.19	\$0.22	\$0.33	\$0.33

## Salem Communications Corporation

## Condensed Consolidated Balance Sheets

(in thousands)

	December 31, 2000	June 30, 2001
Assets		
Cash and cash equivalents	\$3,928	\$54,079
Other current assets	30,617	28,710
Property, plant and equipment, net	69,004	78,764
Intangible assets, net	358,482	300,890
Bond issue costs	2,396	6,614
Other assets	6,241	7,538
Total assets	\$470,668	\$476,595
Liabilities and Stockholders' Equity		
Current liabilities	\$14,593	\$15,163
Long-term debt and capital lease obligations	286,050	303,092
Deferred income taxes	15,279	10,111
Other liabilities	1,798	1,290
Stockholders' equity	152,948	146,939
Total liabilities and stockholders' equity	\$470,668	\$476,595

SALEM COMMUNICATION CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(IN MILLIONS, EXCEPT SHARE AND PER SHARE DATA)

	Projected Three Months Ended September 30,	Projected Three Months Ended December 31,	Projected Year Ended December 31,
	2001	2001	2001
Net broadcasting revenue	\$35.0	\$39.5	\$138.5
Other media revenue	2.0	2.2	8.3
Total revenue	37.0	41.7	146.8
Operating expenses:			
Broadcasting operating expenses	21.7	23.7	86.5



Other media operating expenses	2.4	2.2	9.6
Corporate expenses	3.2	3.2	13.6
Depreciation and amortization	8.5	8.7	32.5
Total operating expenses	35.8	37.8	142.2
Net operating income	1.2	3.9	4.6
Other income (expense):			
Interest income	0.3	0.3	2.2
Gain (loss) on disposal of assets	19.5	--	22.0
Interest expense	(6.9)	(7.0)	(26.7)
Other expense, net	--	--	--
Income (loss) before income taxes and extraordinary item	14.1	(2.8)	2.1
Provision (benefit) for income taxes	5.4	(1.1)	1.0
Income (loss)	\$8.7	\$(1.7)	\$1.1

Basic weighted average net income (loss) per share	\$0.37	\$(0.07)	\$0.04
Basic weighted average shares outstanding	23,456,088	23,456,088	23,456,088

Diluted weighted average net income (loss) per share	\$0.37	\$(0.07)	\$0.04
Diluted weighted average shares outstanding	23,524,003	23,524,003	23,524,003

Other Data (in millions, except margin data):

Broadcast cash flow	\$13.3	\$15.8	\$52.0
Broadcast cash flow margin	38.0%	40.0%	37.5%
EBITDA - broadcasting	10.1	12.6	38.3
EBITDA - other media	(0.4)	--	(1.3)
EBITDA - total	9.7	12.6	37.0
After-tax cash flow - Broadcasting	5.7	7.0	21.1
After-tax cash flow per share - Broadcasting	\$0.24	\$0.30	\$0.90
After-tax cash flow	5.5	7.0	20.3
After-tax cash flow per share	\$0.23	\$0.30	\$0.87

SOURCE Salem Communications Corporation

CONTACT: Media - Amanda Strong of Salem Communications, +1-805-987-0400, ext. 1081, amandas@salem.cc; Analysts and Investors - John Buckley of Brainerd Communicators, +1-212-986-6667, buckley@braincomm.com, for Salem Communications Corporation/



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## PRESS RELEASES

Salem Communications Corporation (ticker: SALM, exchange: NASDAQ) News Release - 9-May-2001

**Salem Communications Announces Record First Quarter 2001 Results**

CAMARILLO, Calif., May 9 /PRNewswire/ -- Salem Communications Corporation (Nasdaq: SALM), the leading provider of Christian-oriented radio, Internet and printed content, announced today record results for the first quarter ended March 31, 2001.

Commenting on the first quarter results, Edward G. Atsinger III, Salem's Chief Executive Officer, said, "We are very pleased with our first quarter financial performance, particularly the growth in our same station revenues and broadcast cash flows. This success highlights the unique nature of our business model and its ability to deliver strong performance, even in a soft economy. We are confident this pattern will continue."

Atsinger continued, "We are also very satisfied with the early ratings success of our new music formatted radio stations, all of which delivered strong ratings growth in the most recent numbers. We expect to translate this ratings success into strong revenue and cash flow growth in the second half of 2001."

For the quarter ended March 31, 2001, net broadcasting revenue increased 33.2% to \$30.1 million from \$22.6 million in the same period a year ago. This reflects growth at existing radio stations as well as the impact of newly acquired properties. Broadcast cash flow increased 3.0% to \$10.2 million from \$9.9 million in 2000.

On a same station basis net broadcasting revenue and broadcast cash flow increased 12.2 % and 11.4%, respectively, for the first quarter of 2001 as compared to 2000.

Broadcast cash flow as a percentage of net revenues decreased to 33.9% in the first quarter of 2001 from 43.8% in the first quarter of 2000. This was due to the impact of start-up costs associated with WYGY-FM Cincinnati, WFSH-FM Atlanta, KFSH-FM Los Angeles, and WZFS-FM Chicago. The launches of these new music formatted stations are expected to favorably impact both revenues and broadcast cash flow in the second half of 2001 and in 2002.

Broadcast EBITDA, excluding the company's non-broadcast media businesses, for the quarter ended March 31, 2001 decreased by 14.7% to \$6.4 million from \$7.5 million in the same period in 2000.

The company's non-broadcast media businesses, OnePlace.com and CCM Communications generated a loss of \$0.6 million for the quarter, before depreciation and amortization, compared with a loss of \$2.4 million in the same period last year.

EBITDA for the quarter ended March 31, 2001 increased by 13.7% to \$5.8 million from \$5.1 million in the same period in 2000.

Broadcast after tax cash flow, excluding the company's non-broadcast media businesses, was \$3.0 million, or \$ 0.13 per share, for the first quarter of 2001 compared to \$4.7 million, or \$0.20 per share for the comparable 2000 period.

After tax cash flow was \$2.6 million, or \$0.11 per share, for the first quarter of 2001 compared to \$3.3 million, or \$0.14 per share for the comparable 2000 period.

The company reported a net loss of \$4.7 million for the quarter, or \$0.20 loss per share, compared to a net loss of \$1.7 million, or \$0.07 loss per share, for the comparable 2000 period.

Per share numbers were calculated based on 23,456,088 weighted average shares for the quarter ended March 31, 2001 and for the comparable 2000 period.

#### Station Acquisitions and Sales

Additionally, during the first quarter, Salem made a number of acquisitions and sales of radio stations including:

- The completion of the acquisition of WYLL-AM (formerly WXRT-AM) in Chicago from Infinity Broadcasting for \$29 million.
- The completion of the acquisition of WWTC-AM in Minneapolis and WZER-AM in Milwaukee from Catholic Radio Network for \$6.9 million.
- The completion of the acquisition of WFIA-AM in Louisville from Blue Chip Broadcasting for \$1.8 million.
- The announcement of the acquisition of WROL-AM in Boston from Carter Broadcasting for \$11 million.
- In addition, in January of 2001, the company completed the sale of KALC-FM in Denver to Emmis Communications for approximately \$100 million.

Since the end of the first quarter:

- Completed the acquisition of WROL-AM in Boston
- Salem Radio Network has signed an agreement to purchase the Dame-Gallagher Networks. With this transaction, SRN acquires ownership of the Mike Gallagher Show and adds another 190 radio stations to our affiliate base.

#### Second Quarter 2001 Outlook

Salem achieved same station revenue growth of 11% for April 2001. Salem expects to achieve second quarter same station revenue growth in the low double digits.

Based on current pacsings, Salem expects net broadcast revenues and broadcast cash flow for the second quarter of 2001 to be approximately \$33.9 million and \$12.3 million respectively. These projections are increased slightly from previous guidance. Also, Salem is projecting broadcast after tax cash flow of \$0.22 per share and after tax cash flow of \$0.20 per share for the second quarter.

#### 2001 Outlook

For the year ending December 31, 2001, Salem is projecting net broadcasting revenue of \$139.6 million for 2001, a 26.8% increase from \$110.1 million for 2000. Broadcast cash flow is projected to increase to \$56.1 million, a 13.6% increase from \$49.4 million in 2000. Projected broadcast cash flow is negatively impacted by start-up costs associated with WYGY-FM Cincinnati, WFSH-FM Atlanta, KFSH-FM Los Angeles, WCLV-FM Cleveland, and WZFS-FM Chicago. These station launches in the fourth quarter of 2000 and first quarter 2001 are expected to favorably impact both revenues and broadcast cash flow in the second half of 2001 and in 2002. Same station net broadcasting revenue and broadcast cash flow are each projected to increase by 10% and 12% as compared to 2000.

Projected net broadcast revenue and broadcast cash flow have been updated from previous guidance to reflect the impact of:

- First quarter 2001 results
- Delayed completion of the acquisitions of WCLV-FM in Cleveland and WYLL-AM in Chicago.
- The acquisitions of WROL-AM Boston, WFIA-AM Louisville and Dame-Gallagher Networks, as well as several further potential acquisitions that we expect to announce in the near future.

Broadcast EBITDA, excluding the company's non-broadcast media businesses, is projected to increase to \$42.8 million in 2001, an increase of 9.7% from \$39.0 million in 2000.

The company's non-broadcast media businesses are projected to generate a loss of \$2 million for the year compared to \$7.0 million in 2000.

EBITDA is projected to increase to \$40.8 million in 2001, an increase of 27.5% from \$32.0 million. Broadcast after tax cash flow is projected to be \$1.06 per share for 2001 compared to \$0.99 per share for 2000. After tax cash flow is projected to be \$1.01 per share for 2001 compared to \$0.80 per share for 2000.

Per share numbers are calculated based on 23,456,088 average shares outstanding for both 2000 and 2001.

Salem will host a teleconference to discuss first quarter results today at 11:30 AM Eastern Time. In order to access this teleconference live, please visit the company's web site at <http://www.salem.cc> or dial 212-896-6065. A replay of the teleconference will be archived on the company's web site or will be available for 48 hours by dialing 800-633-8284, reservation # 18795861.

Salem Communications Corporation is headquartered in Camarillo, California. Upon the close of all announced transactions, the company will own and/or operate 76 radio stations, including 53 stations in the top 25 markets. In addition to its radio properties, Salem owns the Salem Radio Network, which syndicates talk programming, news and music to more than 1,400 affiliated radio stations throughout the United States; OnePlace.com, the online division of Salem Communications; and CCM Communications, the leading publisher of contemporary Christian music trade and consumer publications.

#### Forward-Looking Statements

Statements used in this press release that relate to future plans, events, financial results, prospects or performance are forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those anticipated as a result of certain risks and uncertainties, including but not limited to the ability of Salem to close and integrate announced transactions, market acceptance of recently launched music formats, competition in the radio broadcast, Internet and publishing industries and from new technologies, adverse economic conditions, and other risks and uncertainties detailed from time to time in Salem's periodic reports on Forms 10-K, 10-Q and 8-K filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Salem undertakes no obligation to update or revise any forward-looking statements to reflect new information, changed circumstances or unanticipated events.

SALEM COMMUNICATIONS CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
For the Quarter Ended March 31, 2001  
(in thousands, except share, per share and other data)

	Three Months Ended March	
	2000	2001
Gross broadcasting revenue	\$24,662	\$32,904
Less agency commissions	2,053	2,818
Net broadcasting revenue	22,609	30,086

Other media revenue	1,791	1,965
Total revenue	24,400	32,051
Operating expenses:		
Broadcasting operating expenses	12,705	19,850
Other media operating expenses	4,144	2,536
Corporate expenses	2,454	3,868
Stock and related cash grant	--	--
Depreciation and amortization	4,939	7,273
Total operating expenses	24,242	33,527
Net operating income	158	(1,476)
Other income (expense):		
Interest income	288	795
Gain (loss) on disposal of assets	--	(8)
Interest expense	(2,520)	(6,467)
Other expense, net	(287)	(55)
Income (loss) before income taxes and extraordinary item	(2,361)	(7,211)
Provision (benefit) for income taxes	(704)	(2,549)
Income (loss) before extraordinary item	(1,657)	(4,662)
Extraordinary loss net of income tax benefit	--	--
Net income (loss)	\$ (1,657)	\$ (4,662)
Basic and diluted net income (loss) per share	\$ (0.07)	\$ (0.20)
Basic and diluted weighted average shares outstanding	23,456,088	23,456,088
Other Data (in thousands, except margin and per share data):		
Broadcast cash flow	\$9,904	\$10,236
Broadcast cash flow margin	43.8%	33.9%
EBITDA -- broadcasting	7,450	6,368
EBITDA -- other media	(2,353)	(571)
EBITDA -- total	5,097	5,797
After-tax cash flow -- broadcasting	4,694	2,959
After-tax cash flow per share	\$0.20	\$0.13

SALEM COMMUNICATIONS CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(in thousands)

	December 31, 2000	March 31, 2001
Assets		
Current assets	\$34,545	\$90,863
Property, plant and equipment, net	69,004	76,294
Intangible assets, net	358,482	291,745
Bond issue costs	2,396	2,307
Other assets	6,241	5,552
Total assets	\$470,668	\$466,761
Liabilities and Stockholders' Equity		
Current liabilities	\$14,593	\$19,411
Long-term debt and capital lease obligations	286,050	287,050
Deferred income taxes	15,279	10,653
Other liabilities	1,798	1,361
Stockholders' equity	152,948	148,286
Total liabilities and stockholders' equity	\$470,668	\$466,761

SALEM COMMUNICATION CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(in millions, except share and per share data)

	Projected Three Months Ended June 30, 2001	Projected Year Ended December 31, 2001
Net broadcasting revenue	\$33.9	\$139.6
Other media revenue	2.0	8.5
Total revenue	35.9	148.1
Operating expenses:		
Broadcasting operating expenses	21.6	83.5
Other media operating expenses	2.9	10.5
Corporate expenses	3.4	13.3
Depreciation and amortization	8.7	35.1
Total operating expenses	36.6	142.4
Net operating income	(0.7)	5.7
Other income (expense):	--	--
Interest income	0.6	2.3
Gain (loss) on disposal of assets	--	19.5
Interest expense	(6.5)	(26.9)
Other expense, net	--	--
Income (loss) before income taxes and extraordinary item	(6.6)	0.6
Provision (benefit) for income taxes	(2.5)	0.4
Income (loss)	\$(4.1)	\$0.2
Basic weighted average net income (loss) per share	\$(0.17)	\$0.01
Basic weighted average shares outstanding	23,456,088	23,456,088
Diluted weighted average net income (loss) per share	\$(0.17)	\$0.01
Diluted weighted average shares outstanding	23,524,003	23,524,003
Other Data (in millions, except margin data):		
Broadcast cash flow	\$12.3	\$56.1
Broadcast cash flow margin	36.3%	40.2%
EBITDA -- broadcasting	8.9	42.8
EBITDA -- other media	(0.9)	(2.0)
EBITDA -- total	8.0	40.8
After-tax cash flow -- Broadcasting	5.1	24.8
After-tax cash flow per share -- Broadcasting	\$0.22	\$1.06
After-tax cash flow	4.6	23.6
After-tax cash flow per share	\$0.20	\$1.01

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SOURCE Salem Communications Corporation

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PRESS RELEASE

Salem Communications Corporation (ticker: SALM, exchange: NASDAQ) News Release - 8-Mar-2001

**Salem Communications Announces Record Fourth Quarter 2000 Results**

CAMARILLO, Calif., March 8 /PRNewswire/ -- Salem Communications Corporation (Nasdaq: SALM), the leading provider of Christian-oriented radio, Internet and printed content, announced today record results for the fourth quarter ended December 31, 2000.

Commenting on the fourth quarter, Edward G. Atsinger III, Salem's Chief Executive Officer, said, "Our strong fourth quarter results highlight our unique position in radio, as well as the strength of our business model. Our fourth quarter same station revenues and broadcast cash flow increases of 14% and 22%, respectively, underscore Salem's ability to deliver strong results in the face of a slowing economy. Salem's core broadcasting revenues are stable, and we believe, recession resilient due to the loyalty of our listening audience and the inherent long-term nature of block programming. In addition, we have been very satisfied with the early ratings performance of our recently launched music formats and we look forward to translating our early ratings success into financial results in 2001 and beyond.

"During the fourth quarter we also enhanced our position in a number of key markets, including Chicago, Cleveland, Minneapolis and Boston. Our major market presence, including stations in 9 of the top 10 markets and 22 of the top 25, provides us with a national platform for reaching the Christian community. Salem is well positioned to continue to deliver results above the industry average."

**Fourth Quarter Results**

For the quarter ended December 31, 2000, net broadcasting revenue increased 47.7% to \$35.0 million from \$23.7 million in the same period a year ago. Broadcast cash flow increased 47.3% to \$16.2 million from \$11.0 million in the corresponding 1999 period. These results reflect growth at existing radio stations as well as the impact of newly acquired properties. On a same station basis, net broadcasting revenue and broadcast cash flow increased 14% and 22% respectively, for the fourth quarter of 2000 as compared to the fourth quarter of 1999.

Broadcast cash flow as a percentage of net revenues decreased slightly to 46.2% in the fourth quarter of 2000 from 46.3% in the fourth quarter of 1999. This was due to the impact of recently acquired radio stations that are currently operating at lower margins than existing stations. The company expects this percentage to improve as these recently acquired radio stations grow and mature.

Broadcast EBITDA, excluding the company's non-broadcast media businesses, increased 53.4% to \$13.5 million in the fourth quarter of 2000 compared to \$8.8 million in 1999.

The company's non-broadcast media businesses, OnePlace.com and CCM Communications, generated a loss of \$1.4 million for the quarter, before depreciation and amortization, compared to a loss of \$1.3 million for the same period in 1999.

Broadcast after tax cash flow was \$7.2 million, or \$0.31 per share, for the fourth quarter of 2000 compared to \$6.0 million, or \$0.26 per share, for the comparable 1999 period.

The company reported a net loss of \$3.6 million for the quarter, or \$0.15 loss per share, compared with net income of \$0.5 million, or \$0.02 income per share, in the same period last year. The net loss for the quarter ending December 31, 2000 included an extraordinary loss (net of income tax benefit) of \$1.2

million, or \$0.05 loss per share, resulting from the early repayment of the Company's bridge loan.

Per share numbers were calculated based on 23,456,088 weighted average shares for the quarter ended December 31, 2000, and for the comparable 1999 period.

#### Full Year 2000 Results

For the twelve months ended December 31, 2000, net broadcasting revenue increased 26.4% to \$110.1 million from \$87.1 million in the same period a year ago. Broadcast cash flow increased 20.8% to \$49.4 million from \$40.9 million in the comparable 1999 period. For the twelve months ended December 31, 2000, same station net broadcasting revenue and broadcast cash flow increased 13% and 16%, respectively, as compared to the comparable 1999 period.

Broadcast EBITDA, excluding the company's non-broadcast media businesses, increased 20.7% to \$39.0 million in the twelve months ended December 31, 2000, compared to \$32.3 million in the comparable 1999 period.

The company's non-broadcast media businesses generated a loss of \$7.0 million for the twelve months ended December 31, 2000, before depreciation and amortization, compared to a loss of \$3.6 million in the comparable 1999 period.

Broadcast after tax cash flow was \$23.2 million, or \$0.99 per share for the twelve months of 2000 compared to \$17.9 million, or \$0.89 per share, for the comparable 1999 period.

The company reported net income of \$10.1 million for the twelve months ended December 31, 2000, or \$0.43 per share, compared with a net loss of \$8.0 million, or \$0.40 loss per share in the comparable 1999 period. The net income for the twelve months ending December 31, 2000 includes a gain on the sale of assets of \$29.6 million consisting of a gain on the sale of KLTX-AM Los Angeles and KPRZ-FM Colorado Springs offset by the loss on the sale of certain assets of the company's non-broadcast media businesses. Net income for the 2000 period also included an extraordinary loss (net of income tax benefit) of \$1.2 million, or \$0.05 loss per share resulting from the early repayment of the Company's bridge loan. The net loss for the 1999 period included an extraordinary loss (net of income tax benefit) of \$3.6 million, or \$0.18 loss per share, resulting from the early retirement of \$50 million of the Company's Senior Subordinated Notes.

Per share numbers were calculated based on 23,456,088 weighted average shares for the twelve months ended December 31, 2000, and 20,066,006 shares in the comparable 1999 period.

#### Station Acquisitions and Sales

Additionally, during the fourth quarter, Salem announced a number of acquisitions, swaps and sales of radio stations including:

- The acquisition of WXRT-AM in Chicago from Infinity Broadcasting for \$29 million.
- A three-way asset exchange agreement with Radio Seaway and Clear Channel Communications involving the Cleveland market. Salem is acquiring the transmitting facility of WCLV-FM in exchange for WHK-AM, WHK-FM and \$10.5 million.
- The acquisition of WWTC-AM in Minneapolis and WZER-AM in Milwaukee from Catholic Radio Network for \$7 million.
- The acquisition of WGTK-AM and WFIA-AM in Louisville from Truth Broadcasting Corporation and Blue Chip Broadcasting, Ltd. for \$1.7 and \$1.75 million respectively.
- The acquisition of WROL-AM in Boston from Carter Broadcasting for \$11 million.
- In addition, in January of 2001, the company completed the sale of KALC-FM in Denver to Emmis Communications for approximately \$98 million.

#### First Quarter 2001 Outlook

Salem achieved same station revenue growth of 12% for January 2001 and 11% for February 2001, which is slightly higher than our previous projections. As of March 1, the Company has already achieved same station revenue growth for March 2001 of 4% with four weeks to go. Salem continues to expect first quarter same station revenue growth in the low double digits.

Based on current pascings, Salem expects net broadcast revenues and broadcast cash flow for the first quarter of 2001 to be approximately \$29.5 million and \$9.5 million respectively. Also, Salem is projecting broadcast after tax cash flow of \$0.10 per share for the first quarter. These projections have increased slightly from previous guidance.

#### 2001 Outlook

For the year ending December 31, 2001, we are leaving our guidance unchanged at this time. As previously stated, Salem is projecting net broadcasting revenue of \$138 million for 2001, a 25.3% increase from \$110.1 million for 2000. Broadcast cash flow is projected to increase to \$56 million, a 13.4% increase from \$49.4 million in 2000. Projected broadcast cash flow is negatively impacted by start-up costs associated with WYGY-FM Cincinnati, WFSH-FM Atlanta, KFSH-FM Los Angeles, WCLV-FM Cleveland, and WZFS-FM Chicago. These station launches in the fourth quarter of 2000 and first half of 2001 are expected to favorably impact both revenues and broadcast cash flow in the second half of 2001 and in 2002. Same station net broadcasting revenue and broadcast cash flow are each projected to increase by 10% and 12% as compared to 2000.

Broadcast EBITDA, excluding the company's non-broadcast media businesses, is projected to increase to \$43 million in 2001, an increase of 10.3% from \$39.0 million in 2000.

The company's non-broadcast media businesses are projected to generate a loss of \$2 million for 2001 compared to \$7.0 million in 2000.

Broadcast after tax cash flow is projected to be \$1.06 per share for 2001 compared to \$0.99 per share for 2000.

Per share numbers are calculated based on 23,456,088 average shares outstanding for both 2000 and 2001.

Salem will host a teleconference to discuss third quarter results today at 11:30 AM Eastern Time. To access this teleconference live, please visit the company's web site at <http://www.salem.cc> or dial 212-896-6082. A replay of the teleconference will be archived on the company's web site or will be available for 48 hours by dialing 800-633-8284, reservation # 18113735.

Salem Communications Corporation is headquartered in Camarillo, California. Upon the close of all announced transactions, the company will own and/or operate 76 radio stations, including 53 stations in the top 25 markets. In addition to its radio properties, Salem owns the Salem Radio Network, which syndicates talk programming, news and music to more than 1,400 affiliated radio stations throughout the United States; OnePlace.com, the online division of Salem Communications; and CCM Communications, the leading publisher of contemporary Christian music trade and consumer publications.

(Please see the following financial tables.)

#### Forward-Looking Statements

Statements used in this press release that relate to future plans, events, financial results, prospects or performance are forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those anticipated as a result of certain risks and uncertainties, including but not limited to the ability of Salem to close and integrate announced transactions, market acceptance of recently launched music formats, competition in the radio broadcast, Internet and publishing industries and from new technologies, adverse economic conditions, and other risks and uncertainties detailed from time to time in Salem's periodic reports on Forms 10-K, 10-Q and 8-K filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Salem undertakes no obligation to update or revise any forward-looking statements to reflect new information, changed circumstances or unanticipated events.

Salem Communications Corporation  
Condensed Consolidated Statements of Operations  
For the Quarter and Twelve Months Ended December 31, 2000  
(in thousands, except share, per share and other data)

	Three Months Ended December		Twelve Months Ended December	
	1999	2000	1999	2000
Gross broadcasting revenue	\$25,962	\$38,135	\$95,277	\$120,123
Less agency commissions	2,227	3,124	8,155	10,026
Net broadcasting revenue	23,735	35,011	87,122	110,097
Other media revenue	2,473	1,968	6,424	7,916
Total revenue	26,208	36,979	93,546	118,013
Operating expenses:				
Broadcasting operating expenses	12,744	18,832	46,291	60,714
Other media operating expenses	3,774	3,350	9,985	14,863
Corporate expenses	2,176	2,667	8,507	10,457
Stock and related cash grant	--	--	2,550	--
Depreciation and amortization	4,726	8,486	18,233	25,479
Total operating expenses	23,420	33,335	85,566	111,513
Net operating income	2,788	3,644	7,980	6,500
Other income (expense):				
Interest income	467	108	1,005	534
Gain (loss) on disposal of assets	(22)	(418)	(219)	29,567
Interest expense	(2,536)	(7,436)	(14,219)	(17,452)
Other expense, net	(267)	(48)	(633)	(857)
Income (loss) before income taxes and extraordinary item	430	(4,150)	(6,086)	18,292
Provision (benefit) for income taxes	(57)	(1,751)	(1,611)	6,996
Income (loss) before extraordinary item	487	(2,399)	(4,475)	11,296
Extraordinary loss net of income tax benefit	--	(1,187)	(3,570)	(1,187)
Net income (loss)	\$487	\$(3,586)	\$(8,045)	\$10,109
Basic and diluted net income (loss) per share before extraordinary item	\$0.02	\$(0.10)	\$(0.22)	\$0.48
Extraordinary loss	\$--	\$(0.05)	\$(0.18)	\$(0.05)
Basic and diluted net income (loss) per share	\$0.02	\$(0.15)	\$(0.40)	\$0.43
Basic weighted average shares outstanding	23,456,088	23,456,088	20,066,006	23,456,088
Diluted weighted average shares outstanding	23,456,088	23,466,849	20,066,006	23,466,849
Other Data (in thousands, except margin data):				
Broadcast cash flow	\$10,991	\$16,179	\$40,831	\$49,383
Broadcast cash flow margin	46.3%	46.2%	46.9%	44.9%
EBITDA (excludes stock grant expense) -				
broadcasting	8,815	13,512	32,324	38,926
EBITDA - other media	(1,301)	(1,382)	(3,561)	(6,947)
EBITDA - total	7,514	12,130	28,763	31,979
After-tax cash flow -				
broadcasting (excludes stock grant expense)	6,007	7,167	17,946	23,203
After-tax cash flow per share	0.26	0.31	0.89	0.99

Salem Communications Corporation  
Condensed Consolidated Balance Sheets  
(in thousands)

	December 31, 1999	December 31, 2000
Assets		
Current assets	\$55,515	\$34,545
Property, plant and equipment, net	50,665	69,004
Intangible assets, net	150,520	358,482
Bond issue costs	2,750	2,396
Other assets	4,914	6,241
Total assets	\$264,364	\$470,668
Liabilities and Stockholders' Equity		
Current liabilities	\$13,515	\$14,593
Long-term debt and capital lease obligations	100,087	286,050
Deferred income taxes	7,232	15,279
Other liabilities	691	1,798
Stockholders' equity	142,839	152,948
Total liabilities and stockholders' equity	\$264,364	\$470,668

SOURCE Salem Communications Corporation

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## PRESS RELEASES

Salem Communications Corporation (ticker: SALM, exchange: NASDAQ) News Release - 9-Nov-2000

**Salem Communications Announces Record Third Quarter 2000 Results**

CAMARILLO, Calif., Nov. 9 /PRNewswire/ -- Salem Communications Corporation (Nasdaq: SALM), the leading provider of Christian-oriented radio, Internet and printed content, announced today record results for the third quarter ended September 30, 2000.

**Quarterly Results**

For the quarter ended September 30, 2000, net broadcasting revenue increased 28.2% to \$27.7 million from \$21.6 million in the same period a year ago. Broadcast cash flow increased 15.4% to \$12.0 million from \$10.4 million in the corresponding 1999 period. These results reflect growth at existing radio stations as well as the impact of newly acquired properties. On a same station basis, net broadcasting revenue and broadcast cash flow increased 13% and 7% respectively, for the third quarter of 2000 as compared to the third quarter of 1999.

The same station broadcast cash flow increase was negatively impacted by the reduced operating efficiencies in the company's Los Angeles, Colorado Springs and Houston market clusters due to the sales of KLTX-AM, KPRZ-FM and KKHT-FM. Excluding these markets, same station broadcast cash flow would have increased by 12%.

Broadcast cash flow as a percentage of net revenues decreased to 43.3% in the third quarter of 2000 from 48.1% in the third quarter of 1999. This was due to the impact of newly acquired radio stations that are currently operating at lower margins than existing stations. The company expects this percentage to improve as it integrates these stations into existing market clusters.

EBITDA, excluding the company's non-broadcast media businesses, increased 13.1% to \$9.5 million in the third quarter of 2000 compared to \$8.4 million in 1999.

The company's non-broadcast media businesses, OnePlace.com and CCM Communications, generated a loss of \$1.2 million for the quarter, before depreciation and amortization, compared to a loss of \$1.4 million for the same period in 1999.

Broadcast after tax cash flow was \$5.6 million, or \$0.24 per share, for the third quarter of 2000 compared to \$5.4 million, or \$0.23 per share, for the comparable 1999 period.

The company reported net income of \$13.8 million for the quarter, or \$0.59 per share, compared with a loss of \$3.7 million, or \$0.16 loss per share, in the same period last year. The net income for the quarter ending September 30, 2000 includes a gain on sale of assets of \$25.6 million, as a result of the sale of KLTX-AM Los Angeles offset by the loss on sale of certain assets of the company's non-broadcast media businesses. The net loss for the quarter ending September 30, 1999 included an extraordinary loss (net of income tax benefit) of \$3.6 million, or \$0.15 loss per share, resulting from the early retirement of \$50 million of the company's senior subordinated notes.

Per share numbers were calculated based on 23,456,088 weighted average shares for

the quarter ended September 30, 2000, and for the comparable 1999 period.

#### Year To Date Results

For the nine months ended September 30, 2000, net broadcasting revenue increased 18.5% to \$75.1 million from \$63.4 million in the same period a year ago. Broadcast cash flow increased 11.4% to \$33.2 million from \$29.8 million in the comparable 1999 period. For the first nine months of 2000, same station net broadcasting revenue and broadcast cash flow increased 11% and 9%, respectively, as compared to the comparable 1999 period.

For the nine months ended September 30, 2000, the same station broadcast cash flow increase was negatively impacted by the reduced operating efficiencies in the company's Los Angeles, Colorado Springs and Houston market clusters due to the sales of KLTX-AM, KPRZ-FM and KKHT-FM. Excluding these markets, same station broadcast cash flow would have been increased by 11%.

EBITDA, excluding the company's non-broadcast media businesses, increased 8.1% to \$25.4 million in the nine months ended September 30, 2000, compared to \$23.5 million in the comparable 1999 period.

The company's non-broadcast media businesses generated a loss of \$5.6 million for the nine months ended September 30, 2000, before depreciation and amortization, compared to a loss of \$2.3 million in the comparable 1999 period.

Broadcast after tax cash flow was \$16.1 million, or \$0.69 per share for the first nine months of 2000 compared to \$11.9 million, or \$0.63 per share, for the comparable 1999 period.

The company reported net income of \$13.7 million for the nine months ended September 30, 2000, or \$0.59 per share, compared with a net loss of \$8.5 million, or \$0.45 loss per share in the comparable 1999 period. The net income for the nine months ending September 30, 2000 includes a gain on the sale of assets of \$30.0 million consisting of a gain on the sale of KLTX-AM Los Angeles and KPRZ-FM Colorado Springs offset by the loss on the sale of certain assets of the company's non-broadcast media businesses. The net loss for the 1999 period included an extraordinary loss (net of income tax benefit) of \$3.6 million, or \$0.19 loss per share, resulting from the early retirement of \$50 million of the company's senior subordinated notes.

Per share numbers were calculated based on 23,456,088 weighted average shares for the nine months ended September 30, 2000, and 18,935,978 shares in the comparable 1999 period.

Edward G. Atsinger III, Salem's Chief Executive Officer, commented, "Our record third quarter results highlight the benefits of Salem's unique business model, especially given the recent softening advertising trends in the radio industry. We are very pleased to have achieved same station revenue growth of 13% in the quarter, given some of the softness reported by others in the industry. We have utilized our diversified media platform to establish a dominant position in serving the nation's Christian community, an attractive and growing audience. Our platform is, we believe, recession resistant due to the extreme loyalty of our audiences and the long-term commitment of our block program customer base.

"Our outlook is very positive. We are leveraging our block programming strategy, niche leadership position and solid reputation among our block program customers to produce consistent revenue growth. We have also launched a Christian music format which leverages our station clusters and allows us to offer advertisers and programmers a full suite of marketing opportunities in conjunction with our talk and news formats. Growth in our network operations and in our national rep. firm is also strong, providing programming to over 1,350 affiliates. Our Internet business is also trending well and remains on track to break even by the fourth quarter of 2001."

#### Station Acquisitions and Sales

Additionally, during the third quarter, Salem completed or announced a number of acquisitions, swaps and sales of radio stations including:

- The purchase of eight stations from Clear Channel for \$185.6 million.
- The sale of KLTX-AM Los Angeles for \$29.5 million.
- The acquisition of Christian music station KLTY-FM in Dallas in exchange for KDGE-FM, also in Dallas.
- The acquisition of license and transmitting facilities of WALR-FM, Atlanta, KLUP-AM, San Antonio and WSUN-AM Tampa in exchange for the license and transmitting facilities of KKHT-FM, Houston.
- The sale of KALC-FM, Denver to Emmis Communications for \$98.8 million.

#### Debt Restructuring

The company also announced today that it has completed the restructuring of its debt. The company borrowed \$48.3 million under its existing revolving credit agreement to pay off short-term bridge financing, which Salem had entered into in August 2000 to facilitate the acquisition of the Clear Channel radio stations. By restructuring the debt, Salem has eliminated the uncertainty related to the use of short-term bridge financing, as well as improved the company's average effective interest rate to 9.125% from 11.69%.

#### Outlook

Effective with this announcement and the recent adoption by the Securities and Exchange Commission of Regulation FD, Salem Communications has adopted a policy to provide guidance to investors regarding our financial prospects. The following statements are based on current expectations. These statements are forward-looking and actual results may differ materially. See "Forward-Looking Statements" below. Salem Communications undertakes no obligation to update these statements.

Salem has achieved same station revenue growth of approximately 15% for October 2000. As of November 3, 2000, Salem has already achieved same station growth of 8% for November with four weeks to go. We anticipate that November 2000 same station growth will be in the low double digits. The rise in October is due to election related advertising revenues. As a result, Salem expects fourth quarter 2000 same station revenue growth in the low double digits.

For the fourth quarter as a whole, we are projecting net broadcast revenues and broadcast cash flows of \$33 million and \$16 million respectively. We have increased our revenue projections due to strong same station growth as well as the favorable impact of recently acquired stations. We have slightly reduced our broadcast cash flow projections as a result of start-up costs associated with WYGY-FM Cincinnati, WFSH-FM Atlanta, and KFSH-FM Los Angeles. Due to the completion of the purchase of these radio stations in the third quarter, we have decided to accelerate the promotional launch of these radio stations from 2001, in order to rapidly improve our ratings performance in these markets. We believe this decision will favorably impact both our revenues and broadcast cash flows for 2001. In addition, as a result of paying off the bridge loan, as described above, we expect that interest expense will be lower than previously estimated. As a result we are projecting broadcast after tax cash flow of \$0.28 per share, which is within the range of analysts' estimates.

Salem will host a teleconference to discuss third quarter results today at 11:30 AM Eastern Time. To access this teleconference live, please visit the company's web site at <http://www.salem.cc> or dial 212-231-6025. A replay of the teleconference will be archived on the company's web site or will be available for 48 hours by dialing 800-633-8284, reservation # 16829435.

Salem Communications Corporation is headquartered in Camarillo, California. Upon the close of all announced transactions, the company will own and/or operate 71 radio stations, including 51 stations in the top 25 markets. In addition to its radio properties, Salem owns the Salem Radio Network, which syndicates talk programming, news and music to more than 1,350 affiliated radio stations throughout the United States; OnePlace.com, the online division of Salem Communications; and CCM



Communications, the leading publisher of contemporary Christian music trade and consumer publications.

### Forward-Looking Statements

Statements used in this press release that relate to future plans, events, financial results, prospects or performance are forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those anticipated as a result of certain risks and uncertainties, market acceptance of recently launched music formats including but not limited to the ability of Salem to close and integrate announced transactions, competition in the radio broadcast, Internet and publishing industries and from new technologies, adverse economic conditions, and other risks and uncertainties detailed from time to time in Salem's periodic reports on Forms 10-K, 10-Q and 8-K filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Salem undertakes no obligation to update or revise any forward-looking statements to reflect new information, changed circumstances or unanticipated events.

Salem Communications Corporation  
Condensed Consolidated Statements of Operations  
For the Quarter and Nine Months Ended September 30, 2000  
(in thousands, except share, per share and other data)

	Three Months Ended September		Nine Months Ended September	
	1999	2000	1999	2000
Gross broadcasting revenue	\$23,584	\$30,227	\$69,315	\$81,989
Less agency commissions	2,020	2,567	5,928	6,902
Net broadcasting revenue	21,564	27,660	63,387	75,087
Other media revenue	1,536	2,151	3,951	5,948
Total revenue	23,100	29,811	67,338	81,035
Operating expenses:				
Broadcasting operating expenses	11,198	15,671	33,547	41,882
Other media operating expenses	2,939	3,398	6,211	11,513
Corporate expenses	1,967	2,518	6,331	7,790
Stock and related cash grant	--	--	2,550	--
Depreciation and amortization	4,651	6,655	13,507	16,993
Total operating expenses	20,755	28,242	62,146	78,178
Net operating income	2,345	1,569	5,192	2,857
Other income (expense):				
Interest income	489	75	538	426
Gain (loss) on disposal of assets	--	25,577	(197)	29,985
Interest expense	(2,756)	(4,797)	(11,683)	(10,016)
Other expense, net	(170)	(355)	(366)	(775)
Income (loss) before income taxes and extraordinary item	(92)	22,069	(6,516)	22,477
Provision (benefit) for income taxes	46	8,283	(1,554)	8,747
Income (loss) before extraordinary item	(138)	13,786	(4,962)	13,730
Extraordinary loss net of income tax benefit	(3,570)	--	(3,570)	--
Net income (loss)	\$(3,708)	\$13,786	\$(8,532)	\$13,730
Basic and diluted net income (loss) per share before extraordinary item	\$(0.01)	\$0.59	\$(0.26)	\$0.59
Extraordinary loss	\$(0.15)	\$--	\$(0.19)	\$--
Basic and diluted net income (loss) per share	\$(0.16)	\$0.59	\$(0.45)	\$0.59
Basic and diluted weighted average shares outstanding	23,456,088	23,456,088	18,935,978	23,456,088

Other Data (in thousands, except margin data):

Broadcast cash flow	\$10,366	\$11,989	\$29,840	\$33,205
Broadcast cash flow margin	48.1%	43.3%	47.0%	44.2%
EBITDA (excludes stock grant expense)				
- broadcasting	\$8,399	\$9,471	\$23,509	\$25,415
EBITDA - other media	\$ (1,403)	\$ (1,247)	\$ (2,260)	\$ (5,565)
EBITDA - total	\$6,996	\$8,224	\$21,249	\$19,850

After-tax cash flow broadcasting (excludes stock grant expense)	\$5,355	\$5,602	\$11,939	\$16,127
After-tax cash flow per share	\$0.23	\$0.24	\$0.63	\$0.69

Salem Communications Corporation  
Condensed Consolidated Balance Sheets (in thousands)

	December 31, 1999	September 30, 2000
Assets		
Current assets	\$55,515	\$39,900
Property, plant and equipment, net	50,665	67,138
Intangible assets, net	150,520	357,040
Bond issue costs	2,750	2,485
Other assets	4,914	7,613
Total assets	\$264,364	\$474,176
Liabilities and Stockholders' Equity		
Current liabilities	\$13,515	\$68,105
Long-term debt and capital lease obligations	100,087	230,750
Deferred income taxes	7,232	17,718
Other liabilities	691	1,034
Stockholders' equity	142,839	156,569
Total liabilities and stockholders' equity	\$264,364	\$474,176

SOURCE Salem Communications Corporation

CONTACT: Media - Tricia Whitehead of Spinhouse Public Relations, 615-559-7746, spinhouse@home.com; Analysts and Investors - John Buckley of Brainerd Communicators, buckley@braincomm.com, 212-986-6667, for Salem Communications Corporation

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## PRESS RELEASES

Salem Communications Corporation (ticker: SALM, exchange: NASDAQ) News Release - 8-Aug-2000

### **Salem Communications Announces Record Second Quarter 2000 Results**

CAMARILLO, Calif., Aug. 8 /PRNewswire/ -- Salem Communications Corporation (Nasdaq: SALM), the leading provider of Christian-oriented radio, electronic and printed resources, announced today record results for the second quarter ended June 30, 2000.

For the quarter ended June 30, 2000, net broadcasting revenue increased 15.9% to \$24.8 million from \$21.4 million in the same period a year ago. Broadcast cash flow increased 8.7% to \$11.3 million from \$10.4 million in 1999. These results reflect growth at existing radio stations and revenue and broadcast cash flow related to acquired properties.

On a same station basis net broadcasting revenue and broadcast cash flow increased 11.2% and 9.6%, respectively, for the second quarter in 2000 as compared to 1999.

EBITDA excluding our non-broadcast media businesses increased 7.6% to \$8.5 million in the second quarter of 2000 compared to \$7.9 million in 1999.

The company's non-broadcast media businesses, OnePlace.com and CCM Communications acquired in January 1999, generated a loss of \$2.0 million for the quarter, before depreciation and amortization, compared to a loss of \$0.7 million for the same period in 1999.

The company reported net income of \$1.6 million for the quarter, or \$0.07 per share, compared with a loss of (\$0.21) per share in the same period last year.

Per share numbers were calculated based on 23,456,088 weighted average shares for the quarter ended June 30, 2000, and 16,690,758 shares in 1999.

Edward G. Atsinger III, Salem's Chief Executive Officer, commented, "During the second quarter we were successful in strengthening our national platform of broadcasting, print and Internet assets. We enhanced our presence in some of the nation's most attractive markets, closing on our previously announced acquisition in Dallas and signing an agreement to acquire a fourth station in Atlanta, a second in San Antonio and a station in Tampa. Upon the close of all announced transactions, we will have a broadcasting presence in nine of the top-ten and 22 of the top-25 markets, operating at least a duopoly in seven of the top-10 markets.

"We also made substantial progress in our Internet initiative, tightening our focus around positioning this division to primarily support and strengthen Salem's radio business. As a result, we expect our streamlined Internet division to reach profitability during the fourth quarter of 2001. In total, we have assembled a premier group of assets and have solidified our position as the leader in the distribution of Christian and family issues radio content."

Atsinger continued, "Our record financial results, as well as our continued ability to raise the necessary capital to fund our growth, prove that our strategy is working. Looking ahead, we remain committed to serving the needs of our listeners, advertisers and programming customers. We believe this is the best way to improve results and increase shareholder value over the long-term."

For the six months ended June 30, 2000, net broadcasting revenue increased 13.4% to \$47.4 million from \$41.8 million in the same period a year ago. Broadcast cash flow increased 8.7% to \$21.2 million from \$19.5 million in 1999.

On a same station basis net broadcasting revenue and broadcast cash flow increased 9.6% and 9.7%, respectively, for the first six months of 2000 as compared to 1999.

EBITDA excluding our non-broadcast media businesses increased 4.6% to \$15.9 million in the six months ended June 30, 2000, compared to \$15.2 million in 1999.

The company's non-broadcast media businesses generated a loss of \$4.3 million for the six months ended June 30, 2000, before depreciation and amortization, compared to a loss of \$0.9 million for the same period in 1999.

The company reported a net loss of \$56,000 for the six months ended June 30, 2000, or (\$0.00) per share, compared with a net loss of (\$0.29) per share in the same period last year.

Per share numbers were calculated based on 23,456,088 weighted average shares for the six months ended June 30, 2000, and 16,675,923 shares for the previous period.

Salem Communications Corporation is headquartered in Camarillo, California. Upon the close of all announced transactions, the company will own and/or operate 72 radio stations, including 53 stations in the top 25 markets. In addition to its radio properties, Salem owns the Salem Radio Network, which syndicates talk programming, news and music to more than 1,300 affiliated radio stations throughout the United States; OnePlace, Ltd., a technology company which operates the Christian web portal OnePlace.com; and CCM Communications, the leading publisher of contemporary Christian music trade and consumer publications.

(Please see the attached financial tables.)

Statements used in this press release that relate to future plans, events, financial results, prospects or performance are forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those anticipated as a result of certain risks and uncertainties, including but not limited to the ability of Salem to close and integrate announced transactions, competition in the radio broadcast, Internet and publishing industries and from new technologies, adverse economic conditions, and other risks and uncertainties detailed from time to time in Salem's periodic reports on Forms 10-K, 10-Q and 8-K filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Salem undertakes no obligation to update or revise any forward-looking statements to reflect new information, changed circumstances or unanticipated events.

Salem Communications Corporation  
Condensed Consolidated Statements of Operations

(in thousands, except share, per share and other data)

	Three Months Ended June		Six Months Ended June	
	1999	2000	1999	2000
Gross broadcasting revenue	\$23,405	\$27,100	\$45,731	\$51,762
Less agency commissions	2,007	2,282	3,908	4,335
Net broadcasting revenue	21,398	24,818	41,823	47,427
Other media revenue	1,320	2,006	2,415	3,797
Total revenue	22,718	26,824	44,238	51,224
Operating expenses:				
Broadcasting operating expenses	10,970	13,506	22,349	26,211
operating expenses	1,974	3,971	3,272	8,115
Corporate expenses	2,568	2,818	4,364	5,272
Stock and related cash grant	2,550	-	2,550	-

Depreciation and amortization	4,745	5,399	8,856	10,338
Total operating expenses	22,807	25,694	41,391	49,936
Net operating income	(89)	1,130	2,847	1,288
Other income (expense):				
Interest income	24	63	49	351
Gain (loss) on disposal of assets	(197)	4,408	(197)	4,408
Interest expense	(4,552)	(2,699)	(8,927)	(5,219)
Other expense, net	(76)	(133)	(196)	(420)
Income (loss) before income taxes	(4,890)	2,769	(6,424)	408
Provision (benefit) for income taxes	(1,374)	1,168	(1,600)	464
Net income (loss)	\$(3,516)	\$1,601	\$(4,824)	\$(56)
Basic and diluted net income (loss) per share	\$(0.21)	\$0.07	\$(0.29)	\$(0.00)
Basic and diluted weighted average shares outstanding	16,690,758	23,456,088	16,675,923	23,456,088
Other Data (in millions, except margin data):				
Broadcast cash flow	\$10.4	\$11.3	\$19.5	\$21.2
Broadcast cash flow margin	48.6%	45.6%	46.6%	44.7%
EBITDA (excludes stock grant expense)				
- broadcasting	\$7.9	\$8.5	\$15.2	\$15.9
EBITDA - other media	\$(0.7)	\$(2.0)	\$(0.9)	\$(4.3)
EBITDA - total	\$7.2	\$6.5	\$14.3	\$11.6
After-tax cash flow - broadcasting (excludes stock grant expense)	\$3.7	\$5.5	\$6.9	\$10.2
After-tax cash flow per share	\$0.22	\$0.23	\$0.42	\$0.44

Salem Communications Corporation  
Condensed Consolidated Balance Sheets  
(in thousands)

	December 31, 1999	June 30, 2000
Assets		
Current assets	\$55,515	\$26,328
Property, plant and equipment, net	50,665	56,795
Intangible assets, net	150,520	187,342
Bond issue costs	2,750	2,573
Other assets	4,914	3,575
Total assets	\$264,364	\$276,613
Liabilities and Stockholders' Equity		
Current liabilities	\$13,515	\$10,968
Long-term debt and capital lease obligations	100,087	113,092
Deferred income taxes	7,232	8,802
Other liabilities	691	968
Stockholders' equity	142,839	142,783
Total liabilities and stockholders' equity	\$264,364	\$276,613

SOURCE Salem Communications Corporation

CONTACT: Tricia Whitehead of Spinhouse Public Relations, 615-559-7746, or e-mail, [spinhouse@home.com](mailto:spinhouse@home.com); or John Buckley of Brainerd Communicators

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Citation	Search Result	Rank 1 of 1	Database
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Los Angeles Business Journal

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Monday, January 29, 2001

ISSN: 0194-2603; Volume 23; Issue 5

Christian Media Company Targeting Growing Market.  
CHRIS SIEROTY

FULL TEXT

IT may not own the nation's largest radio network, but Salem Communications Corp. has been successful targeting a market estimated to be worth more than \$3 billion annually.

The Camarillo-based Christian multimedia company's core business is owning and operating radio stations. Founded almost three decades ago, Salem today is filling the airwaves and cyberspace with around-the-clock programming designed to meet the spiritual and informational needs of the nation's estimated 30 million Christian conservatives.

Analysts expect the company's shares to get a boost from increases in advertising and block-programming revenues, along with the expected profitability of its Internet business.

Since going public in July 1999 at \$22.50 a share, Salem's stock has been on a roller-coaster ride, dropping to a 52-week low of \$6.12 last April after closing as high as \$30 in October 1999.

As of last week, the stock was trading at slightly above \$15 a share.

"Salem shares present a compelling buy, as I believe that they should trade at a multiple closer to their peers," said James M. Marsh of Prudential Securities Inc. "In particular, the shares will trade at a multiple closer to its (annual revenue) growth rate of 14 to 15 percent."

Marsh is projecting a 12-month price target of \$25.

Mark O'Brien, vice president of BIA Financial Network in Chantilly, Va., said Salem shares took a beating last year because the company purchased a number of expensive radio stations in large markets.

"Investors were concerned that flipping all those stations (to a Christian format) would hurt revenues," he said. "They were also

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Concerned that Salem was only growing (revenues) by 10 percent during the first half of the year, while other radio companies were growing by 20 percent."

O'Brien expects Salem's revenue growth to begin accelerating, however, as it begins attracting more advertisers eager to sell to the Christian market. Many of the stations have been reformatted to feature talk, music or religious programming.

The consumer spending power of the Christian market is huge, meaning Salem has plenty of advertisers eager to access its audience. The Christian retail industry, including books and music, generated an estimated \$3.5 billion in revenues during 2000, said Brandt Gustavson, president of the Manassas, Va.-based trade group National Religious Broadcasters.

Salem currently owns and/or operates 76 stations nationwide, including 54 stations in the top 25 markets, with plans to acquire additional stations and integrate those with its multimedia assets. For example, listeners can log onto a Salem-owned radio station's Web site and follow a link to a Salem-owned publication or online ministry.

David Evans, Salem's chief financial officer, said the company purchased 20 stations in 2000, with four more deals expected to close in the first half of this year.

"We need to continue to improve our new stations in an effort to grow their revenues," he said. "These stations represent a large portion of our portfolio."

Salem's six Los Angeles properties include KRLA-AM (870), formerly KIEV-AM, and KKLA-FM (99.5).

While Salem does not expect to release its fourth-quarter and year-end 2000 financial results until March, the company is projecting broadcast revenues of \$138 million for the year, with 55 percent of that coming from advertising, and the rest coming from block-programming sales. (Block programming is similar to infomercials, in that a third-party entity, in this case a religious-oriented party, buys a block of air time--typically 15 or 30 minutes -- and then airs their own programming.)

"Our (spot) advertising sales will gradually increase over the next few years because we have launched a number of music and talk stations that are 100 percent driven by advertising," said Evans.

Much of that spot advertising growth is being attracted by Salem's "Contemporary Christian" music format, essentially light rock with a religious message targeted to a young audience.



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Besides its radio stations, the company operates Salem Radio Network, which syndicates programming to more than 1,300 stations nationwide.

Salem Communications Corp.

YEAR (Dec.31)	1999	1998
Revenue (millions)	\$93.5	\$77.9
Operating Expenses (millions)	85.5	64
Operating Income (millions)	8.0	13.9
Net Loss (millions)	(8.0)	(1.6)
LOSS Per Share	(\$0.40)	(\$0.09)

## SUMMARY

Business: Religious radio broadcaster

Headquarters: Camarillo

CEO: Edward G. Atsinger III

Market Cap: \$360.6 million

Dividend Yield: N/A [\*]

Total Liabilities: \$318 million

P/E Ratio: 24.4

Long-Term Debt: \$289 million

## ---- INDEX REFERENCES ----

KEY WORDS: RADIO BROADCASTING; UNITED STATES; SALES, PROFITS & DIVIDENDS; RADIO BROADCASTING

NEWS SUBJECT: Earnings; English language content; Religion; Political and General News; Religion; Corporate and Industrial News; Performance (C151 ENGL GREL GCAT RLG CCAT C15)

MARKET SECTOR: Consumer Cyclical (CYC)

INDUSTRY: Broadcasting; Media: Radio Broadcasting; All Entertainment & Leisure; Media (BRD IARB ENT MED)

PRODUCT: Leisure; Media (DLE DME)

SIC: 4832

REGION: United States; North America; United States; North American Countries (US NME USA NAMZ)

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Word Count: 710  
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## PRESS RELEASES

Salem Communications Corporation (ticker: SALM, exchange: NASDAQ) News Release - 8-Mar-2001

## Contemporary Christian Music Signs on in Chicago With WZFS-FM, 106.7 The Fish

CHICAGO, March 8 /PRNewswire/ -- A new contemporary Christian music radio station, WZFS-FM 106.7 The Fish, has signed on the air in the Chicago market, operated by Salem Communications Corporation (Nasdaq: SALM), the leading provider of Christian-oriented radio, electronic and printed resources, announced John Timm, general manager.

Operating with the most powerful commercial FM signal in Northeast Illinois, 106.7 The Fish, becomes the first station to fully cover the #3 Chicago market with the increasingly popular contemporary Christian music format. 106.7 FM had been known as WYLL-FM, a Christian talk format operated by Salem Communications. That format is now on WYLL-AM 1160.

"The Chicago area is the #3 market for Christian music sales, but there has been a huge void in reaching the audience through radio. It is one of the largest major markets in the United States without a good Christian music signal -- until now. We know that there is an enormous audience here excited about our arrival in the market, and we are so happy to be here," said Timm, a 25-year veteran of mainstream radio. "WZFS-FM 106.7 The Fish is going to be as well researched, programmed and produced as any of our general market competitors. But, we will be a positive alternative for both kids and their parents. I think listeners of all faiths will find this music energizing and uplifting."

Presently the station is playing "40 Days and 40 Nights" of continuous music without commercial interruptions, "to give the market a non-stop sampling of the station's new format," said Timm. After a nationwide talent search, Timm expects full-time radio personalities and a program director to be announced in the next month. The station will also be streamed on the Internet live via <http://www.oneplace.com>.

The playlist for The 106.7 The Fish includes core Christian adult contemporary pop and rock artists such as dcTalk, Jars of Clay, Third Day, Steven Curtis Chapman, Michael W. Smith, Jaci Velasquez, The Newsboys, Sixpence None the Richer, Jennifer Knapp, Rebecca St. James, Crystal Lewis, Anointed and Plus One.

With the launching of 106.7 The Fish, Salem Communications now operates nine Christian music stations, including KFSH-FM 95.9 in Los Angeles and WFSH-FM 104.7 in Atlanta. In 2000, Salem Communications also purchased and began operating KLTY-FM in Dallas; the nation's most popular contemporary Christian music station.

The launch of the FISH stations are part of a corporate commitment by Salem Communications to the contemporary Christian music format, according to Edward G. Atsinger III, president and CEO of Salem Communications.

"Salem Communications' corporate strategy is to super-serve the religious and family issues market. With contemporary Christian music growing faster than almost any other style of music, we recognize that music listeners are an important addition to our audience and we will continue to find opportunities to operate music formats in major

markets. We have already seen significant success in Los Angeles and Atlanta. Chicago is another huge market for us and we see a great future for the new station, WZFS-FM, there," Atsinger said.

Salem Communications Corporation is headquartered in Camarillo, California. Upon the close of all announced transactions, the company will own and/or operate 76 radio stations, including 53 stations in the top 25 markets. In addition to its radio properties, Salem owns the Salem Radio Network, which syndicates talk programming, news and music to more than 1,400 affiliated radio stations throughout the United States; OnePlace.com, the online division of Salem Communications; and CCM Communications, the leading publisher of contemporary Christian music trade and consumer publications.

Statements used in this press release that relate to future plans, events, financial results, prospects or performance are forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those anticipated as a result of certain risks and uncertainties, including but not limited to the ability of Salem to close and integrate announced transactions, competition in the radio broadcast, Internet and publishing industries and from new technologies, adverse economic conditions, and other risks and uncertainties detailed from time to time in Salem's periodic reports on Forms 10-K, 10-Q and 8-K filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Salem undertakes no obligation to update or revise any forward-looking statements to reflect new information, changed circumstances or unanticipated events.

SOURCE Salem Communications Corporation

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## PRESS RELEASES

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Salem Communications Corporation (ticker: SALM, exchange: NASDAQ) News Release - 28-Sep-2000

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**Contemporary Christian Music Signs on in Atlanta With the New 104.7 The Fish**

ATLANTA, Sept. 28 /PRNewswire/ -- A new contemporary Christian music radio station, The New 104.7 The Fish, has signed on the air in the Atlanta market, operated by Salem Communications Corporation (Nasdaq: SALM), the leading provider of Christian-oriented radio, electronic and printed resources, announced Allen Power, general manager.

The 100,000-watt WFSH-FM, The New 104.7 The Fish, becomes the first station to fully cover the #11 Atlanta market with the increasingly popular contemporary Christian music format. Salem Communications obtained the radio station through an asset exchange agreement with Cox Radio earlier this year when it acquired Cox's WALR-FM transmitting facility and signal. WALR-FM moves to 104.1 FM.

"The 104.7 signal has historically been one of the strongest in the Atlanta market and we intend to honor that positioning by providing the finest and most entertaining music station in the area," said Allen. "WFSH-FM is going to be as well researched, programmed and produced as any of our general market competitors. Atlanta is the eighth largest market in the United States for sales of contemporary Christian music and is a regular tour stop for many of the top artists in Christian music, so we know there is a enormous audience that is excited about our arrival in this market."

Presently the station is playing continuous music with no personalities, "to give the market a 24-hours a day, non-stop sampling of the station's new format," said Allen. Later this fall, full-time radio personalities will be added. The station will also be streamed on the Internet live via [www.oneplace.com](http://www.oneplace.com).

The playlist for The New 104.7 The Fish includes core Christian adult contemporary pop and rock artists such as dcTalk, Jars of Clay, Steven Curtis Chapman, Michael W. Smith, Jaci Velasquez, The Newsboys, Sixpence None the Richer, Jennifer Knapp, Rebecca St. James, Crystal Lewis, Anointed and Plus One.

Kevin Avery, a veteran of both Christian and mainstream radio, has been named program director for The New 104.7 The Fish. Avery was formerly program director at WAY-FM in West Palm Beach, Florida; that station won a 2000 Dove Award for the Gospel Music Association's Radio Station of the Year.

With the launching of The New 104.7 The Fish, Salem Communications now operates eight Christian music stations, including the recently launched KFSH- FM -- The FISH 95.9 FM -- in Los Angeles. The launches of the two new FISH stations are part of a corporate commitment by Salem Communications to the contemporary Christian music format, according to Edward G. Atsinger III, president and CEO of Salem Communications. (The Fish moniker was chosen for its Christian symbolism. The "Christian fish," known as the Ichthus, was a Greek symbol used by Christians to discreetly identify fellow believers during the early days of Christianity when the Romans were persecuting Christians.)

"Salem Communications' corporate strategy is to super-serve the religious market. With

contemporary Christian music growing faster than almost any other style of music, we recognize that Christian music listeners are an important addition to our audience and will continue to find opportunities to operate Christian music formats in major markets. We are happy with the success that KFSH-FM is experiencing in Los Angeles after only a month on the air. Atlanta is another huge market for us and we see a great future for the new station, WFSH-FM, there." Atsinger said.

Salem Communications Corporation is headquartered in Camarillo, California. Upon the close of all announced transactions, the company will own and/or operate 71 radio stations, including 51 stations in the top 25 markets. In addition to its radio properties, Salem owns the Salem Radio Network, which syndicates talk programming, news and music to more than 1,300 affiliated radio stations throughout the United States; OnePlace.com, the online division of Salem Communications; and CCM Communications, the leading publisher of contemporary Christian music trade and consumer publications.

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